

UNDP / WB Project “Strategy for

MOLDOVA IN TRANSITION

economic survey

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PREFACE

Seven difficult and contradictory years have passed since the Republic of Moldova affirmed itself as a new independent state of Europe, started on the path toward the democratization of society and economic reform, and tried to settle the problems facing it, based on its own resources and with the assistance of international, European and regional structures.

Today it is a certain reality that the Republic of Moldova has come close to the traditional democracies in terms of organization of the state, public pluralism and individual liberties. However, human beings cannot live of spiritual liberty alone.

The economic results of the reforms are, unfortunately, very modest. After the crisis of 1991/1992 (the collapse of the planned economy, hyperinflation, swift decline of output, loss by the population of bank savings), which was followed by the economic depression of 1993/1996, and by a weak growth impulse in 1997, the country, and unexpectedly for the majority of the population, has now been hit by the new crisis of 1998, which led to the devaluation of the national currency, threatening the country with the possibility of defaulting on its debts, and to a paralysis of the energy complex, of entrepreneurship and of the social sphere. The circle has closed up...

The November 1998 issue of 'Moldova in transition' contains articles which evaluate events and key processes of the 'first round' of economic reforms in Moldova. Published by the Center for Strategic Studies and Reforms (in the context of the UNDP/WB project "Strategy for Development"), it reflects exclusively the view point of the authors of the articles, and in no case those of state structures or other organizations.

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The next issue of "Moldova in Transition" (Feb. 1999) will deal with the lessons of 1998, possible scenarios of subsequent transformation of the national economy, and the mechanisms of their realization.

We invite you for collaboration.

1. Seven years – the first round of reforms

Now, at the end of 1998, there is a considerable diversity of opinions regarding the assessment of the seven years of reforms in Moldova – “irreversibility of market economy changes”, “failure of monetarism”, “virtual economy”, “tactical zigzags in strategic direction”, etc. In our opinion, a more balanced analysis of the situation is set forth in the analytical part of the Government Action Plan (approved by Parliament in May 1998), in the latest memoranda signed between the Republic of Moldova and international financial organizations – IMF, WB, EBRD, in the reports of the international rating agencies – Moody’s Investors Service, Fitch IBCA Ltd. Finally, the first systematic investigation has appeared of the process of reforming the economy in the 1990s (I. Guțu, *The Republic of Moldova: Transition Economy*, Chișinău, Litera, 1998).

The main obvious lesson of this period of seven years is clearly that the transition to a market economy includes a combination of political, institutional, economic and social processes which, if they take place in an uncoordinated and inconsequential fashion, can considerably delay the reform process and have a negative impact upon the economy and the living conditions of the population.

The complicated interrelation of these processes has in the end affected the evolution of the indicators of socio-economic development of the country in the 90s. Being a small open country, the Republic of Moldova has been affected in this period by a strong external dependence (energy dependence, Transnistrian problem), as well as by the negative influence of internal economic and political factors.

These factors mentioned above have caused instability of political support for the reforms introduced by Parliament, lack of continuity in actions of six Governments, irrational waste of financial resources and slowing down in the activity of the executive and legislative powers during the frequent electoral periods (1990, 1992, 1994, 1995, 1996, 1998, 1999 and 2000 – all those being election years!). Three electoral campaigns have taken place every four years, all that in conditions of unconsolidated statehood and of an economy with many risk factors.

The main change in the economic policy of Moldova has taken place after 1993. This year marked the line between the state-dominated and market oriented

Of course, this period came after the important events of 1990-1992: liberalization of prices, commerce and enterprise operations, adoption of the first set of laws oriented towards the market economy (laws regarding ownership, privatization, Land Code, etc.), entry into new markets. The first legal documents that formed the basis of the changes in the national economy were: the resolution of Parliament “Regarding the concept of transition to market economy” (1990) and the “Program of transition to market economy in Moldova” (1991).

Yet, the first real program of stabilization of the Moldovan economy was worked out by the Cabinet jointly with the IMF and the WB in 1993. It was targeted to five main objectives: (1) privatization and restructuring of state enterprises; (2) support for the private sector (notably to small and medium sized enterprises), investment promotion; (3) modernization of the financial system (banking, budget); (4) development of an affordable social safety system from active employment policies to anti-poverty measures; and (5) support of the policy reforms, demonstrated through the establishment to regulatory and legislative frameworks.

MAIN MACROECONOMIC INDICATORS *

	1994	1995	1996	1997	1998e
Real GDP growth rate	-30.9%	-1.4%	-7.8%	1.3%	-7.0%
Nominal GDP (excl. Transnistria), lei million	4737	6480	7658	8655	8645
Nominal GDP, USD million	1167	1443	1665	1876	1607
Export (FOB), USD million	618	739	822	851	723
Export, yr/yr	156.5%	119.6%	111.2%	103.5%	85.0%
Import (FOB), USD million	672	794	1056	1235	1150
Import, yr/yr	126.8%	118.2%	133.0%	117.0%	93.1%
Trade balance, USD million	-54.0	-55.0	-234.0	-384.0	-426.7
Current account, USD million	-97	-115	-209	-309	-367
as % of GDP	8.3%	8.0%	12.6%	16.5%	22.8%
Direct investment, USD million	18	73	53	79	90
as % of GDP	1.5%	5.1%	3.2%	4.2%	5.6%
Stock of foreign debt, USD million	627	806	1103	1234	1320
as % of GDP	53.7%	55.8%	66.3%	65.8%	82.1%
New borrowing**, USD million	239	189	180	160	50
Debt servicing**, USD million	18	67	53	161	180
NBM gross forex reserves, USD million	179.8	256.4	313.7	365.7	150.0
Budget deficit as % of GDP	5.8%	5.8%	9.8%	7.7%	2.0%
Annual inflation rate (end period)	104.6%	23.8%	15.1%	11.2%	13.3%
Average inflation rate	487.0%	30.0%	24.0%	12.0%	7.4%
End-year exchange rate, lei/1USD	4.27	4.50	4.65	4.66	8.36
Average exchange rate, lei/1USD	4.06	4.49	4.60	4.61	5.38
Nominal annual appreciation(+)/depreciation(-)	-170.7%	-10.6%	-2.4%	-0.3%	-16.6%
Real annual appreciation(+)/depreciation(-)	-514.8%	+16.2%	+21.0%	+11.7%	-10.4%

* - data for 1991-1993 n/a or not compatible

** - including loans from IMF, World Bank, EBRD, EU etc. + Eurobond issues

It is already obvious that in all of these targets various degree progresses have been reached. To mention is, that 1993-1995 were the years of the “big bang” in the transition from one model of social, political and economic development to another. The new Constitution (July, 1994) included the stipulation that the guideline of the economy of the country “is a market economy, socially oriented, based on both private and public ownership, involved in free competition”. Together with joining the economic union of the CIS, the Republic of Moldova was the first of the post-soviet countries that has been accepted in the Council of Europe, and in November 1994 signed a Partnership and Cooperation Agreement with the European Union.

This was the period when the mass privatization program was implemented (1500 enterprises), the National Bank of Moldova initiated credit auctions, the new national currency was introduced and its stability maintained. The rate of inflation was reduced from 1184% in 1993 to 30% in 1995. The Council of State Creditors and ARIA agency restructured the first group of industrial enterprises. In June 1995 the Stock Exchange started its operations. Most industrial enterprises have been transformed into Joint Stock Companies.

Although the reform in the agrarian sector was suspended and the support of the private sector was insignificant, in this period, according to the annual estimates of the IMF, WB and EBRD, Moldova was ranked higher as compared to most CIS countries and to its neighbors – Romania, Ukraine and Bulgaria. The quotation of the respected magazine “The Economist” (March 1995) is very significant: “Moldova is a model of correct reform, and the fact that it is a small country, transforms it into a perfect laboratory for running reforms”.

1. Seven years – the first round of reforms

Creating, in general, the legal and institutional basis of the market economy and carrying out a macroeconomic stabilization (reduced inflation, stable national currency, budget deficit under control), Moldova nevertheless failed to enter a period of economic growth. The break in the implementation of the reforms, decided by both Parliament and Government, had a negative impact – foreign loans were used for consumption, structural reforms were postponed, political issues prevailed upon economic ones.

The situation of the economy in 1996/97 could be described as a “stable depression” which, under the impact of external and internal pressures, led to the crisis.

Unfortunately, in the Autumn of 1998 Moldova fell under the “shade” of the financial collapse in Russia which, *inter alia*, generated pressures on the banking sector, blocked exports from Moldova to the East (with the consequent budget losses), and caused a rise in the prices of energy products imported from Russia. Taking into account all these factors, the preliminary estimation of GDP for 1998 is of minus 7% (against minus 4.7% in the first quarter).

It is already obvious that in the nearest period the economic and financial immunity of Moldova will be severely tested. For the first time since the introduction of Moldovan leu a real threat arose of the national currency falling and unleashing an inflationary process. The warnings came true regarding the lack of safety of macroeconomic (financial) stability, when it is not supported by reforms of the real sector of the economy and by consolidating the state budget.

In conditions of decline of the productive sector and weakening of the state structures (a significant indicator of this is the shadow economy accounting for 50-60% of GDP), the National Bank of Moldova has proved to be a strong center of the economic policy of the state. Now this image has been considerably compromised: during October 1998 the Moldovan leu devalued by about one-third against the US dollar, and during the last four days of the month the leu fell from 5.83 to 6.40 lei per US dollar. At the end of November the official rate of exchange has reached 9.00, whereas at the exchange offices it reaches even 10.00.

A general awareness has been growing in the country of the real threat to the positive results of the reforms - stable national currency, lucrative banking sector, active private sector and population with average incomes, and the gradual adaptation of the population to living in a market economy. Everybody - even the opposition - became aware of Moldova's dependence of the international financial organizations.

This fact has clearly been noticed in the activity of the Parliament and Government, who intensified the introduction of legal and organizational backing of reforms. It is enough to consider the set of laws discussed and adopted by the Parliament, as well as the actions of the Government in October-November 1998, to understand that the ruling block, the Alliance for Democracy and Reforms, not without difficulties and contradictions, made serious efforts to realize their action program.

It is important that, despite the famous algorithm “2+2+1” which broke up the top leadership of the state apparatus, in September-November the Government not only worked in a regime of crisis management, but also undertook long-run measures: the Government approved the “Strategic guidelines of the social economic development of the Republic of Moldova in 1998-2005” (resolution no. 1107, November 6, 1998), the middle-term program for agro-industrial sector development, etc. Along with this, the Government has laid down the path for the privatization of the energy sector, “MoldTelecom” and the tobacco complex. Due attention was focused on the declarations of the Government regarding the necessity for a *new economic policy*.

The need for a new economic policy for Moldova is determined by the main fact that a real threat has emerged for the economic security of the country. Most indicators, both economic (see table below) and social (table 6.1), are at a critical level.

Indicators of the state economic security, 1998***Initial data for calculation of indicators***

Foreign debt	USD 1.3 bn
GDP	MDL 9 bn
Foreign debt service	USD 60 m
Public debt service	USD 100 m
Total expenditures of state budget	USD 2 bn
Exports	USD 0.7 bn
Imports	USD 1.1 bn

<i>Indicators</i>	<i>Actual</i>	<i>Recommended</i>
1. Foreign debt/GDP	About 80%	65%
2. Foreign debt service/Export	8.6%	5%
3. Public debts service/Total expenditures of state budget	25%	5-7%
4. Three groups of imported goods / Total imports (mineral products, including energy resources, equipment, chemical products).	57.8%	30-35%
5. Three groups of exported goods / Total exports (food products, drinks, cigarettes)	54.8%	20-25%
6. Export to one country (Russia)/Total export	58.2%	25-30%
7. Import from one country (Russia)/Total import	28.5%	15-20%
8. Export/Import	64%	95-100%
9. Degree of customs control in the country	About 70%	100%
10. Share of shadow economy	50-60%	15-20%
11. Share of fiscal evasion / Budget incomes	25%	5-10%
12. Real fiscal burden	55%	25-30%
13. The degree of provisioning with energy resources as at the beginning of the cold season	10%	80-90%

** Source: Reports of the international financial organizations, average levels for developed countries, CISR expert estimations.*

The aggregate indicator of social-economic security, calculated by Prof. C. Zaman based on 10 indicators (demographic, social welfare, financial, external, institutional, etc.), has a value of 3.34, compared with the optimal figure of 10. This means that *in the Republic of Moldova a person has three times less social-economic security than is required for normal functioning of economic, social and political overall activities*. The greatest responsibility for this is borne by the state, since most indicators used in the calculation of this composite indicator relate to economic policies at the central level.

The reality is that at state level it is necessary to implement, within an economic policy, *measures to alleviate and avoid both internal and external threats to the economic security of Moldova*. The primary actions in this field that need to be implemented immediately would comprise *monitoring and forecasting* the basic factors threatening economic security and

1. Seven years – the first round of reforms

determining the thresholds for economic indicators beyond which it is necessary to introduce some extraordinary measures – legal, economic and organizational.

Comparisons with international indicators are extremely unfavorable for Moldova. Thus, according to the estimates of the WB, EBRD, the real GDP in 1997 accounted for 35% (1989=100%), against 37% in the Ukraine, 63% in Bulgaria, and 82% in Romania. GDP per capita (USD according to Purchasing Power Parity (PPP)) was respectively: 1,440 in Moldova, 2,230 in the Ukraine, 4,280 in Bulgaria, and 4,580 in Romania. With a GDP per capita of 1440 USD according to PPP, the Republic of Moldova became one of the poorest countries of Europe. The UNDP ranked Moldova in 110th place among all the countries (191 in all), in its Human Development Index – the same level as in China, Egypt or Bolivia.

What happened? Why didn't Moldova become a model laboratory of reforms, as "The Economist" assumed in 1995? Nowadays, analyzing the events and the trends of the cycle "crisis of 1991/92 – crisis of 1998", the following results and lessons are evident from the first round of reforms:

- *Positive results - property reform has been implemented, a broad legal and institutional basis has been created for market economy*, the private sector produces not less than 60%, prices have been liberalized, as have internal and external trade and enterprise operations, the capital, labor and real estate markets have been established, and a viable banking system was consolidated. All these changes in market economy orientation can really be considered irreversible. However, on this way too many impediments and mistakes have been made.
- The economic reform has been carried out under strong influence of the "*political cycles*", and at the same time without a *national strategy for development*. Thus the continuity of those 6 governments' actions during 1991-98 was not assured.
- *Fragmentation of legislation in the economic domain* the Parliament has not approved yet a Civil Code oriented towards the market economy, most of the laws that regulate the activity of the financial sector (banking sector, stock market, Fiscal Code) are based on the Anglo-Saxon model, whereas the legislation regarding enterprise bankruptcy, foreign investments, etc. is based on the European continental one. Law enforcement is very poor.
- *Lack of coordination* regarding the maintenance of *macroeconomic, financial stability and structural reforms* in the key sectors – energy, industry, agribusiness, social sphere. *Low social and economic efficiency of mass privatization* for patrimonial bonds, lack of real owners in most enterprises after their privatization, lack of conditions for attracting foreign investors. *Lack of a real support by the state to entrepreneurs*. The shadow economy provides at least 30% of jobs and approximately 40-45% of population incomes, which compensates for the state's economic inefficiency.
- *The problem of Transnistria has not been resolved on the basis of European standards for local self-administration*; the political status of Gagauzia was determined (territorial autonomy), yet, in terms of social-economic aspects, the region is hardly viable, the subsidies from the central state being crucial for its development.
- *Lack of constructive character of the social policy*, which for a long time was limited only to cutting budget expenditures; delaying of reforms of the basic branches of the social sphere, as well as of the implementation of the pension system.

For these reasons, opinion polls and of the results of the last parliament elections of 1998 show that at least 40% of the population perceives the economic reforms in a negative manner. The most criticized aspects are the inefficiency and equalizing nature of the social protection

system. Striving not to hurt anybody, including the “new rich”, the state in the end hurts the most needy.

Turning now to the causes of the current economic situation in Moldova, one can conclude, that they result from the attempt to manage the market economy “as in capitalism”, and to have a social sphere and general employment rate “as in socialism” (with paucity of financial means), trying to imitate countries with socially oriented market economies. As for the financial resources and technical assistance which the country receives from abroad, they need to be used for promoting real reforms and not for imitating them.

Unrecovered economic system of the Republic of Moldova still has quite a few risk factors. And the current situation is such, that *regardless to which Cabinet is in power*, it needs to resolve the following set of “*burning*” problems:

- *budget rehabilitation* – reduction of budget costs (because of the commitment to support the agrarian sector, the social sphere, and public administration), tax system’ improvement, and collection of budget revenues as well as contributions to the Social fund;
- *stimulation of the real economic sector, of entrepreneurship*, increasing exports and reducing the deficit in the balance of trade;
- realization of *structural reforms*, including the privatization of the energy sector, MoldTelecom, tobacco sector, and state companies for purchasing and marketing in the agricultural sector;
- continuation of the *agrarian reforms and privatization of land by simultaneous creation of new structures* for providing help with credit, technology, agro-chemicals and other necessary inputs to the private rural sector;
- *reform of the social sphere*;
- *fundamental reform of local administration*, with a view to use more efficiently the territorial resources – natural, demographic and productive.

Undelayed nature of these problems is obvious. Variants are possible only in methods of their approach. Parliament must at the same time ensure the legal provisioning of these measures (implementation of Civil Code, adjustment of laws regulating the financial sector, corporate management, social protection of the mostly vulnerable groups of the population).

Looking for ways to resolve the crisis, redress the economy and improve the living standards of the population *will require a more constructive participation of the state in the transition period*. Noteworthy is, that in the World Bank Yearly Report ’98 particular attention is paid to the need of increasing the role of the state in conditions of crisis economy.

According to the results of the opinion polls (see Chapter 9), the expectations of the population vis-à-vis the role of the state are still exaggerated, for it is the state that was the initiator of the reforms and it must therefore take responsibility for their results.

The generalized dissatisfaction with the situation created in this country gives rise to demands *vis-à-vis* the political power, which should be truly able to guarantee a *balance of interests between state, economic agents and the population*. The solutions are clearly in the field of the institutional reforms, improved mechanisms for economic activity and social protection, and stressing the *national state ideology* - civic consensus, modernization of the economy and transformation of the Republic of Moldova into a civilized country, politically stable, neutral and open to international cooperation, which should be able to ensure economic progress and a decent standard of living for the population.

2. National currency: successful story?

On November 29, 1998 the country will mark the 5th anniversary of the introduction of national currency – Moldovan leu. At this point, it is a good opportunity to assess what the achievements are and how it all went from the very beginning. Of course, the main conclusions remain to be drawn by the National Bank of Moldova (NBM), which played the major part in this act, but nevertheless, an attempt will be made here to draw such an analysis from an independent point of view.

So, was it a successful story? From one prospective the obvious answer is: yes, it was. It was the most important achievement of this country so far in terms of reforming its economy. But from another point of view the answer would be no, it wasn't, because this was practically the *only* achievement, along with failures and delays in implementing the reforms in the real sector of economy. And it has become clear for a year now, that, having a stable currency and a low inflation rate does not implicitly guarantee the success of the economic reforms in general, and the establishment of an attractive investment environment in particular. Moreover, it's not sustainable only by itself. And this was clearly proved by the destabilization in the foreign exchange market which happened in October-November 1998.

Yes, Moldova did have a stable leu and a low inflation, backed by a tight and successful monetary policy implemented by the central bank, but it could not last forever under a blockage of structural reforms in the economy, which generated a persistent huge budget deficit along with a high current account deficit and rapid accumulation of foreign debt. And it all blew up, under the stress of the financial crisis in Russia, at the beginning of November 1998 when it became obvious that such a stability can not be entirely at the expense of the central bank's foreign exchange reserves, which fell dramatically, since NBM was the only source of hard currency in the country. The National Bank obviously could not fulfill a wide range of objectives at the same time: trying to give a hand to the Government by providing direct loans for covering the budget deficit, providing hard currency for servicing the country's foreign debt, and ultimately selling foreign exchange to commercial banks through the Interbank Currency Exchange or directly.

What were the results in the end?

- The same huge budget deficit, generating increasing arrears to the social sphere, pensioners, and employees, with an inability of the state to maintain borrowing in the domestic market to cover current expenditures, including servicing of already issued securities.
- The same enormous trade and respectively current account deficits, resulting mainly from the dramatic decrease of exports caused by the Russian crisis, and at the same time hardly diminishing imports, caused among others by the less elastic energy component. No dynamism in non-CIS exports.
- The increasing huge burden of foreign debt, which demands more than \$200m both in 1998 and in 1999 needed for repayment of interest and principal.
- And... less than \$200m of central bank's foreign exchange reserves, dropping from the \$366m figure at the beginning of 1998.

This dead end must have been foreseen by the Government and Parliament, which should have been more active in implementing the economic reforms in the real sector, and not counting on miracles to happen. The country showed a bright start at the beginning of

1996, when successful monetary policy laid the much needed path for a more active continuation of reforms in the real economy. However, regretfully this chance was lost – no correct conclusions being made and no notable results achieved, in spite of significant additional external financing received also in 1997 resulted from sales of T-Bills, Eurobonds, MIG jets (apart from the World Bank disbursements).

And the NBM, on seeing that, should have tried to assess in a more realistic way the major dangers which were approaching and to ease the significant pressure on the exchange rate, which was backed by foreign exchange reserves. If the NBM limited its interventions in the foreign exchange market at the beginning of the 1998, when it became quite clear that the economic situation did not improve at all, then it would have managed to keep more than half of its net reserves. Of course, this decision would have led immediately to a depreciation of the national currency, as it happened in November, but it wouldn't have been so dramatic, and the impact of Russian crisis would have never been so harmful.

Now, let's see first how it all began... What was the monetary policy in Moldova before the introduction of the national currency? Actually, it was a very weak policy at that stance. But let us follow the historical background.

Ruble zone. Moldova, like other post-communist economies, joined the transition process having a high rate of inflation and massively decreasing production. After the surge in administered prices in early 1992, sharp price increases followed, leading to hyperinflation. Thus, the level of inflation was 1280% in 1992. In such environment the so needed budget deficit reduction was not done. Moreover, this deficit was financed by extensive money printing, as well as preferential centralized loans, which ultimately generated a non-productive consumption, since frequently the loans were absorbed by inefficient state enterprises which should have been either restructured or bankrupted.

The Government did not have the needed resolution (and experience) to perform the radical reforms, combining the transition to a market economy and the hyperinflationary environment. In these circumstances the country needed a stable monetary system, as well as sound banking system.

The currency stabilization environment had to be built up from scratch, since in 1991, when Moldova became an independent state, the foreign exchange and gold reserves were zero, and there was neither a foreign exchange market, nor even a central bank of the state.

As in all other former Soviet republics, in Moldova the Soviet ruble banknote was in circulation. The exchange rate of the ruble against major currencies was set at the auctions of the Moscow Interbank Currency Exchange. Referring to the banking system, only the republican central bank (a branch of the former USSR Gosbank) existed in Moldova, plus several state specialized banks for savings accumulation, budget servicing, agriculture and industry financing. They were receiving financing from the central bank for granting directed credits. Hard currency flows were subject to a strict control, the circulation of hard currencies was banned.

At the beginning of June 1991, Parliament approved the banking laws, which set the legal basis for the 2-tier banking system in Moldova – the central bank and commercial banks. On June 4, 1991 the National Bank of Moldova (NBM) was established. The NBM is independent from the Government and reports only to the Parliament. It is the sole money issuance authority of the state, drawing up and implementing monetary, credit, and foreign exchange policies, setting the regulatory framework for commercial banks and supervising their activity. The first five commercial banks were in fact the former state specialized banks afterwards privatized into joint-stock companies.

Because Moldova continued to remain in the ruble zone, the NBM could not protect the extremely vulnerable national economy from external shocks coming from neighboring countries. The economic policy was not efficient, being constantly altered by negative processes taking place in the former Soviet countries (FSU).

Introduction of coupon. When the inflation in neighboring republics exceeded the inflation in Moldova, and some of them started issuing localized currencies (such as Russian ruble in Russia, which took the place of the Soviet ruble), it has become clear that in order to avoid the total chaos and invasion of Soviet rubles from the entire ruble zone, the domestic market must have been somehow protected. Thus, on June 10, 1992 the NBM put in circulation Moldovan coupons (denomination of 50, 200 and 1000), which were equivalent to Soviet type rubles, and circulated in parallel. By end-June 1993 the coupons accounted for 80% of cash in circulation. The official exchange rate of coupon against US dollar remained the same as of ruble, fixed by Russia.

On July 24, 1998, the Central Bank of Russia decided to ban the circulation of Soviet bank notes on the territory of Russian Federation. The next day, NBM also decided to withdraw Soviet rubles from circulation in Moldova. But it took out only the bank notes with nominal values of more than 100, due to lack of small denominated coupons.

From August 9, 1993, the NBM started an independent weekly quotation of the Moldovan ruble against main currencies, including other rubles of the FSU area, using the cross-rate through the Russian ruble. This greatly contributed to shrinkage of the currency black market.

In the period January-November 1993, the exchange rate of Moldovan coupon against US dollar depreciated by more than nine times. The NBM supported this depreciation policy due to the negative trade balance between Moldova and Russia and import of inflation from the ruble zone.

In October 1993 the Moldovan Interbank Currency Exchange was founded by seven commercial banks as a closed joint stock company. The NBM had only a supervision role. Weekly trading auctions were held at this Bourse, and the exchange rate, was set at the equilibrium point of supply and demand, afterwards automatically becoming the NBM's reference rate for the next day. During the first several weeks of the Bourse's activity, the NBM was the only seller of hard currency in the market, but afterwards the situation became more balanced.

Significantly, after the first few weeks of the Bourse's existence, the exchange rates set at the Bourse, exchange bureaus and street markets have exhibited a high degree of convergence – the unification of exchange rates was achieved *de facto*. This suggests that the markets were broadly competitive.

An important aspect of the NBM's activity at that time was the commencing of collaboration with international financial organizations. On May 5, 1992 Moldova became a member of the EBRD, and on August 12, 1992 Moldova joined the IMF together with the IBRD and IDA. In February 1993 Moldova received its first loan from the IMF for financing the trade deficit (\$4.56m), and shortly after, in March 1993, the first loan from IBRD followed (\$26m) for critical imports.

At that time preparations for the introduction of the national currency started.

In spring 1993 when the fast collapse of Russian ruble became obvious, which was due primarily to expansionary monetary and fiscal policy and huge political instability, some countries of FSU decided to introduce national currencies. The first countries to introduce

currencies were the Baltic States, later, Kyrgyzstan and Moldova followed.

The biggest problem was the type of exchange regime that would be the most appropriate for Moldova. A fixed exchange rate or a pegged regime could at a larger extent expose the economy to shocks, besides the country had no gold of significant hard currency reserves. Thus, Moldova adopted a floating currency regime, or in more exact terms – a managed floating regime.

Introduction of leu. Moldova introduced its national currency, the Moldovan leu, on November 29, 1993. The conversion rate was set to 1 leu for 1000 Moldovan rubles or coupons.

The main task of this extremely important step was to insulate the Moldovan economy from the continued instability of the ruble area. The program of financial stabilization and structural reforms, adopted along with the introduction of the leu, was supported by the IMF through stand-by arrangements. This program, which covered the period through March 1995, was designed to secure a stable leu through the adoption of tight financial policies. The program also sought to advance economic restructuring through the liberalization of domestic and international trade and payments systems and the introduction of key structural reforms. In addition to IMF support, the program was supported by other bilateral and multilateral donors, including the World Bank.

Apart from financial aid, Moldova has received significant and very efficient technical assistance from IMF, continuously provided since 1992. Consequently, NBM became a modern central bank, with qualified staff and equipped according to Western standards. Considerable assistance was provided in the following fields: compilation of monetary statistics, reorganization of payments system, foreign exchange market mechanisms, balance of payments statistics, new accounting system, as well as banking supervision, legal and regulatory issues.

Monetary policy instruments. With the introduction of the Moldovan leu a tight monetary policy was implemented, which proved to be one of the most successful (along with the one of the Baltic States) in the FSU. Briefly it can be described as follows: each year NBM draws the monetary-credit program, based on monetary aggregates, including the following policy goals: Net Foreign Assets (foreign exchange reserves and liabilities), and Net Domestic Assets (ceilings on lending to the Government, to commercial banks, and banks' lending to the economy, as well as targets for cash in circulation, banks' reserves, and deposits). Among the applied instruments of monetary policy there are: reserve requirements, refinancing auctions, interventions in the foreign exchange market, and open market operations with securities. The last one is most recommended, but it started to be utilized only after August 1997, when the securities market was sufficiently developed.

Starting 1995, the budget deficit is covered mainly by issuance of state securities (Treasury bills and bonds) and not only by direct lending from the central bank. Thus, the needed budget funds are attracted from the financial market, avoiding additional money issuance by NBM. The volume of T-Bills to be issued annually is forecasted in the Budget Law, approved by the Parliament. The NBM is the state's fiscal agent which puts state securities in circulation through organizing auctions and negotiating directly with commercial banks, which act as dealers in the primary market.

Foreign investors may participate at auctions without any restrictions.

On March 14, 1995, the NBM organized the first T-Bill auction (3-month maturity), where banks acted as buyers. Since August 1995, auctions started to be held once in two weeks according to the pre-published schedule. In 1995, the supply of state T-Bills was bigger than the demand, mainly due to the following reasons: Ministry of Finance was trying to sell

big amounts of securities, and secondly these securities were not known in the financial market. The volume of issued state securities had a continuous and fast increase, until in 1998 the Government realized that this “pyramidal” practice can not continue any longer, since the budget deficit has not been reduced, and moreover, the proceeds from newly issued bills and bonds did not even cover the amounts needed for securities redemption (1998 evolutions are described a bit further). During 1995-1997 interest rates on state securities gradually decreased following the reduction of inflation, but they were often high enough (also comparing with deposit rates) to allow commercial banks to use available funds for buying T-Bills and getting easy and guaranteed profits, instead of crediting the economy.

The main successes of the monetary policy were stabilization of the national currency and of the inflation rate.

Inflation. The rate of inflation decreased sharply in 1994. If in 1993 annual inflation was more than 2000%, then at the end of in 1994 it came down to 105%, in 1995 it was already 23.8% (IMF target - 15%), in 1996 – 15.1% (target 15%), in 1997 – 11.2% (target 10%). Referring to the average monthly rate of inflation: in 1993 it was 33.9%, in 1994 – 6.2%, in 1995 – 1.8%, in 1996 – 1.8% and in 1997 – 0.9%.

In Moldova, the inflation is characterized by two main factors: monetary factor (as in Western economies) and the non-monetary one. Generally speaking, if the financial market is balanced, than any changes in the monetary supply would affect the inflation without adequate economic variances. However, the Moldovan financial market has not become yet a balanced one. That is why, having an adequate volume of broad money, or an adequate monetary policy of the central bank, does not implicitly mean the total control over the inflation, since the inflation rate could go up influenced by indirect, non-monetary factors, such as administrative increases in prices and tariffs (housing services, transport, energy etc.), or some seasonal tendencies.

Credit allocation. Before 1993 the central bank was providing directed and centralized loans in the amounts requested by the Government. Since August 1993, when the first refinancing auction took place, the main type of credit allocation were credit auctions held at the NBM, where only banks which fulfilled NBM’s requirements could take part in. The approved policy guidelines for 1994 specified that 80% of the central bank’s credit (and for 1995 – 90%) must go through credit auctions (the remaining part was distributed according to Parliament decisions), and these conditions were fulfilled, though few believed back in 1992 that the economy could do well without preferential loans. But it indeed managed well. Market method of granting loans to banks at the auctions proved substantially more efficient. The refinancing rate was equal to the interest rate set at the auctions according to the supply and demand.

In 1994 NBM’s preferential credits (direct loans at low interest rate granted to some economic agents, mainly state enterprises) have been phased out. However, the Government itself continued to provide state guarantees for commercial banks’ loans to some economic agents. On the other hand, NBM continued to provide direct loans to the Ministry of Finance, however, starting with the issuance of state T-Bills in 1995, these credits are granted by the NBM exclusively against state’s T-Bills. The NBM and Ministry of Finance have been working out the possibility of converting old (from 1992) NBM’s loans to Government into state securities, but no securitization of this debt was effected so far, and it’s only being continuously prolonged.

The annual refinancing rate established at credit auctions increased significantly through late 1993 reaching a peak of 377 percent in February 1994. Then, as inflation declined, the auction rate dropped to yearly 42% by end-1994, reducing further to 21% by end-1995. The decrease of inflation rate has had a positive effect on NBM refinancing rate, which beginning with January 1994 became positive in real terms. During 1996 the refinancing rate fluctuated insignificantly around 19-21%, going down to 16% by end-1997.

Real refinancing rate rose significantly in 1994 and peaked by mid-1994 (which brought the first symptoms of suffocating economy and urged NBM to start a decrease in interest rates). Real interest rates in the banking system always remained quite high. Among reasons for this are, on the one hand, high systemic risk, driven by the weakness of court and legal environment (for instance lack of legal basis for land collateral and mortgage loans), and on the other hand, lack of serious competition between banks, as well as their undercapitalization.

The volume of credits auctioned was determined so as to achieve targeted levels of the central bank's NDA, taking into account indicative targets for reserve money and broad money. These targets are consistent with performance criteria under arrangements with the IMF.

The refinancing rate set at the credit auctions has been the key reference rate of NBM. Since August 1997 a new instrument started to be applied – the Lombard facility. The Lombard rate was determined at the level of interest rate on 28-day state securities plus a constant margin (5% or higher). In September 1997 NBM approved the regulations on open market operations – Repo agreements, i.e. selling of state securities with their further repurchase at a specific date at an agreed price. Commercial banks act as primary dealers in these operations.

Monetary aggregates. Reserve money and the money supply increased in 1994 by 128% and 116%, respectively, compared with 320% and 393% in 1993. Tight financial conditions also resulted in a decline in the growth of bank deposits, which increased by 77% in 1994 compared to 212% in 1993. The share of foreign currency deposits in total deposits declined to about 10% at the end of 1994, down from 15 percent at the end of 1993. This reflected an increase in confidence in the leu (supported by the stable exchange rate and the rapid decline in inflation) and the increasing reliance on foreign currency deposits to finance current transactions rather than as a store of value.

During 1995 monetary supply (M_3) increased by 65.2%, because of the increase of cash in circulation (M_0) by 85%. Cash constituted more than 50% of the monetary supply. Deposits in foreign exchange went up by 84%, while deposits in lei – by 38%. Total deposits amounted to 140m lei, or more than \$30m.

In 1996 monetary supply grew by 12.8%. Cash in circulation and sight deposits (M_1) constituted 65.5%, showing a 2.3% decrease over previous year. The volume of time deposits and foreign exchange deposits (quasy money) grew up respectively, reaching a share of 34.5% of M_3 .

During 1997 broad money increased by 34%. It happened mainly due to the growth of cash in circulation by 33%, which in 1996 was by 14.4%. Deposits constituted already 49.4% of the broad money, and the biggest share of them was in national currency, which actually proved the confidence of households and economic agents in leu, and its stability.

The National Bank, as the central bank, sets commercial banks' reserve requirement according to the implemented monetary policy. A more aggressive utilization of this instrument took place in 1994. Till February 1, 1994 mandatory reserves for sight deposits was equal to 20% of the total attracted funds, while for the time deposits the requirement was lower (15% and less). Then, in order to limit the money in circulation, NBM raised the

reserve requirement up to 28%. And from June 1, 1994, seeing that the level of inflation has decreased, NBM lowered the reserve requirement back to 20%. From December 16, 1994 NBM set a unique reserve requirement for all deposits equal to 12%. From October 1, 1995 it was set at 8%. In 1996 NBM transposed the reserve requirement (8%) to the foreign exchange deposits. The situation changed dramatically in the last quarter of 1998, but this aspect will be analyzed in the "Latest developments" subsection below.

Exchange rate. The initial exchange rate of the leu was set at 3.85 lei per 1 US dollar. Further on, the official rate was fixed at the sessions of the Moldovan Interbank Currency Exchange. Official rate applies to foreign exchange transactions carried out by the NBM, including external debt service, and is used for accounting and tax valuation purposes.

From October 14, 1993, the fixing sessions of the Chişinău Bourse were held on a weekly basis, and starting December 10, 1993 they were held twice a week. Since January 1, 1994 – thrice a week. Already in 1995 the NBM introduced daily quoting (from February 1, 1995) of the USD, RUR, ROL and DEM.

Due to the fact that the lag between exchange rates in the cash and non-cash markets was expanding, in December 1993 the NBM made several interventions at the exchange bureaus, buying US dollars and after a while selling them back. Thus, the nominal exchange rate was at first even appreciating, reaching 3.665 lei per USD during 20-25 January 1994. Afterwards the rate started to slowly depreciate. Relatively high interventions were made by the NBM in 1994, mainly in the cash market. Because of panic among population, and increased demand for hard currency in spring 1994, the exchange bureaus raised sharply the exchange rate in April 1994, so that the NBM decided to make a massive intervention and sold around one million USD in cash (quite a lot for that time). Then, after a short stabilization, another hit followed, and NBM sold in May another 700 thousand dollars cash to the exchange bureaus. Interventions proved to be quite successful and the central bank afterwards bought the foreign exchange back, at a convenient rate. This was a good example of how the NBM stood the speculations in the foreign exchange market.

During 1993 the coupon depreciated by 900%, while already in 1994 the Moldovan leu depreciated against the US dollar only by 13%. Further on leu showed a remarkable stability, and the yearly nominal depreciation index was: 5.4% in 1995, 2.6% in 1996, and 0.23% in 1997. The stable exchange rate was used as a second anchor (apart from the tight monetary policy) for keeping the inflation in place. However, over a medium and long-term period, only one anchor, i.e. monetary policy, should be sufficient.

Along with the reduction of inflation, the Moldovan leu started to appreciate in real terms against the Russian ruble, Ukrainian karbovanets, US dollar and other currencies. Thus, the real exchange rate index indicated an appreciation of leu against US dollar by about 78% in 1994, by 16.6% in 1995, 12.1% in 1996, and 11% in 1997.

As it can be seen, in real terms there was a sharp appreciation of the leu over this period. Moreover, overvaluation of the leu, in the presence of huge and rising Balance of Payments disequilibrium (current account to GDP ratio was 15.8% in 1997), encouraged organized speculative drive against the leu. The nominal *effective* exchange rate showed in 1997 an appreciation of Moldovan leu by 36% against currencies of the main trading partners of Moldova – Russia, Ukraine, Belarus, Romania, Bulgaria, Germany and Italy. The real effective rate, which also takes into account the inflation in Moldova and the above countries, indicated an appreciation by 16%. This evolution of the national currency has generated many objections (especially in 1997) from the exporters' side, which claimed that an overvalued value of leu made Moldovan exported goods too expensive, thus deteriorating

their competitiveness. At the same time, it was believed that a devaluation of leu would cut the massive imports, especially of commodity goods. But, on the other hand, NBM claimed that the devaluation would not solve this problem, since almost one third of imports were energy resources. Besides, it was stressed that a depreciation would cause problems to the Government in terms of external debt service, and also would cause the reduction of households' real incomes.

Analyzing the path of the exchange rate during 1994-1997, it may be seen that there were some common tendencies generated by seasonal fluctuations of the supply and demand for hard currency in the forex market. They are explained by the seasonal character of Moldova's economy, which is strongly relying on the agriculture sector. In spring NBM usually sold hard currency due to the high demand from economic agents related to the procurement of fuel etc. needed for the sowing period. Then, later in the year, when the production is harvested and exported, there are inflows of hard currency sold in the market, and bought by the NBM for completing its reserves. Before the beginning of winter preparations are being made (energy imports) which contribute again to an increase in demand for foreign exchange etc.

During 1994-1997 NBM has been intervening on the foreign exchange market for attenuating sharp exchange rate fluctuations, according to the goals of the monetary policy. However, in spite of the relatively reduced scale of its interventions (with some exceptions), the NBM always had a notable psychological influence on the participants of the forex market. It is explained by the fact that, having significant foreign exchange reserves, NBM could virtually satisfy almost any demand on the small Moldova's currency market. Thus, the exchange rate was closely supervised by the central bank, while commercial banks and economic agents were monitoring NBM's interventions in the market, which could implicitly reshuffle the exchange rate, thus causing them losses.

Foreign exchange regime. The NBM has been gradually implementing a policy of foreign exchange market liberalization. Since 1992 positive changes in currency regulations emerged: till May 1992 mandatory sale of hard currency constituted 50% of the proceeds from production activity and 60% in case of intermediaries. Thereafter the surrender requirement has been gradually unified, accounting for 35% by end-1993. Moreover, while in 1993 exports proceeds have been sold to the NBM, starting January 1994 they are sold to commercial banks. Complying with the surrender requirement, till the end of 1993 economic entities sold \$11.4m which completed the NBM's foreign exchange reserves, that at the end of 1993 stood at \$77m. On January 17, 1994 NBM approved the new Regulation on Currency Control, which authorized buying of hard currency for current account operations. From November 15, 1994 the surrender requirement was cancelled, thus economic agents being able to freely dispose of their export earnings, kept with banks. This was a strong evidence of leu's stability.

The building up of reserves evolved further. Thus, at the end of 1994 gross reserves already reached \$180m, 1995 - \$256m, 1996 - \$314m. At end-1997 gross reserves reached - \$366m (covering 3.1 months of imports of goods and services), out of which \$132m represented net reserves. Increase of reserves was mainly due to NBM's interventions in the foreign exchange market (where there was a higher supply of foreign exchange, resulted from exports, foreign investments, and foreign loans), and also due to a successful management of the reserve portfolio done by central bank's dealers (placements on deposits with foreign banks, Repos, investments in US Treasury securities and others).

Rules of export-import of hard currency in Moldova have been simplified, while quite liberal regulations have been set regarding keeping hard currency on deposits with Moldovan banks. These actions led to a growing confidence in leu from population and economic entities. Consequently, the exchange rate of leu has stabilized, the volume of lei deposits with banks increased, while the “street” activities and black currency market phenomena have practically wiped out.

The above mentioned measures and results obtained served as a good reason for the NBM to accept on June 30, 1995 the Article VIII, sections 2, 3, 4 of the IMF Articles of Agreement. This represented *de jure* the convertibility of Moldovan leu for current account operations, and for some capital account operations. As a result, any resident or non-resident individual or legal entity have been allowed to exchange with no limits lei into hard currencies (and some non-convertible currencies, for instance of FSU countries) and *vice-versa*. Foreign investors were granted the right to freely repatriate capital to their country of origin. Any economic agent of Moldova can buy hard currency amounts for import operations, without limitations, through Moldovan commercial banks. Economic entities have been allowed, in cases when they received loans from abroad, registered at the NBM, to buy hard currency in the local market for servicing these loans. Residents, working abroad, can freely transfer their earnings to relatives in Moldova. However, individuals residents of Moldova are not allowed to transfer abroad the money from their hard currency accounts with local banks, with a few exceptions such as for medical care, studies and other.

The stability of the exchange rates of commercial banks was proving that the domestic foreign exchange market was stabilized due to the fact that commercial banks started to work independently in cash supplying. Moreover, it should be noted that since 1994 the exchange rates set by commercial banks for transfers and the rates set by the exchange bureaus for cash transactions did not differ much from the official rate. This meant that the foreign exchange market in Moldova was fairly developed, hard currency was widely accessible, and the situation had a sustainable stability.

Generally speaking, to the establishment and stabilization of Moldovan foreign exchange market contributed: instituting of the Interbank Currency Exchange, creation of the securities market, NBM's Clearing Center, as well as the activity of a large number of foreign exchange bureaus, which together with commercial banks, are providing currency exchange services in Moldova.

A particular importance for Moldova had the long-term financial assistance received from the IMF and World Bank during 1993-1997. In total IMF made available \$242m, through CCFF, STF, Stand-by and EFF facilities - for balance of payments support, national currency support, and structural adjustment. The World Bank provided \$265m, for financing critical imports, export promotion, financing budget deficit, private sector development, and also structural adjustment. Moldova also received considerable loans from donor countries, European Community, and private banks.

However, in mid-1997 IMF stopped the disbursements under the Extended Fund Facility. One of the main reasons was the slow progress in curbing the fiscal deficit in 1997. Other important factors were over limit deficit financing from the central bank, as well as internal payments and external debt arrears. Missed IMF targets had a knock-out effect to World Bank funding and disbursements from SAL2 also ceased. Instead of reducing the deficit, the authorities (in absence of multilateral funding, and reluctance of NBM to extend unlimited credit to the Government) have increasingly resorted to private borrowing – launch of Moldovan Eurobonds and encouraging foreign investors to buy domestic T-Bills. This

ultimately led to the expansion of crisis in the financial sphere (because the budget deficit still has not been reduced), which was strongly catalyzed by the Russian crisis later in August 1998.

Latest evolutions in 1998. The situation on the Moldovan financial market during 1998 remained relatively stable, except for the period influenced by Russian financial crisis, which started at mid-August 1998. The Russian crisis along with serious undermining of Moldovan exports, had also a major negative impact on local financial market. The majority of foreign portfolio investors withdrew their capitals invested in State Treasury Bills (total foreign investments in state securities had reached around \$30m, i.e. one third of the total). At the same time, starting end-August people began converting their lei deposits with commercial banks into hard currency ones, some entirely withdrawing their funds from the banking system.

These actions were particularly driven by the events happened on “black Friday” – September 4, 1998 – when many exchange bureaus in Chişinău, supported by one commercial bank tried irresponsible speculative actions against the lei (under conditions of temporary shortage of cash hard currency in the market), raising the US dollar selling rate to 6-7 lei per 1 US\$. Moreover, they violated several regulations, changing the rates several times a day and fixing much higher spreads comparing to the 10% allowed ones. Energetic steps taken by the NBM, which helped commercial banks, selling them several millions of US dollars in cash on Saturday, plus inspections and massive withdrawal of licenses of exchange bureaus (along with tightening of buying-selling spread), helped to calm the situation, and starting Monday, September 7, the dollar selling rates have fallen back to 4.9 lei/\$.

At that time NBM decided to limit hard currency interventions, keeping them at lowest possible level, obviously driven by the decision to protect its diminishing FX reserves. This, in its turn kept the demand for dollars in the market. The NBM has been selling hard currency during all the sessions of the Interbank Currency Exchange in September-October, and the official exchange rate was firmly depreciating:

At October 8 the official exchange rate reached for the first time 5.00 lei per 1USD.

At October 29 the official exchange rate reached the level of 6.00 lei per 1USD.

At November 7 the official exchange rate reached the level of 7.01 lei per 1USD, and then lei continued to depreciate, approaching 10 lei/1USD by end-November.

The National Bank had an opportunity to consider the IMF warning, expressed on October 14, 1998 and stop selling hard currency in the interbank market. But NBM's management decided to make another attempt to stabilize the lei, using one of the pivots of monetary policy – mandatory reserves of commercial banks at the central bank. Thus, on October 14, 1998 NBM's Administrative Council adopted a decision to raise the reserve requirement from 8% to 25% starting October 25, which generated a lot of arguments (and a part of them quite sensible) against it, coming from commercial banks.

Obviously NBM counted on the fact that, lacking cash lei, the banks would start selling hard currency at the Interbank Bourse in order to get cash lei. The NBM's goal was to diminish banks' growing demand for hard currency, by diminishing their liquidity in national currency, and thus stabilizing Moldovan lei and stopping the decrease of official foreign exchange reserves. But it did not happen that way. A number of banks indeed started to accumulate the required reserves at the NBM, but till the end of October no bank managed to accomplish this task (the deadline being set for November 5, 1998).

Starting November 2, 1998 the NBM decided to temporary withdraw from selling hard currency at the Interbank Currency Exchange (also reducing the reserve requirement to 15%, though provided that 10% of banks' total assets must be in the form of state securities).

It was a long way to this wise decision, which should have been done already somewhere in the first quarter of 1998. Now, the official exchange rate is being set as a weighted average of rates of the banks' foreign exchange transactions. Thus, banks are put in the position to find all by themselves the equilibrium point of the supply and demand for hard currency in the market. And it seems that they manage to do the job. Banks even agreed between themselves to cancel the results of Bourse transactions if the exchange rate of lei falls beyond 10%.

Of course, central bank's decision to stop the interventions generated a considerable initial increase in the price of dollar because of the shortage of dollars which are not coming from the NBM reserves anymore. And the one transaction that took place on November 2 was a proof to this, though a pale one, since the volume of transaction was very insignificant, and the surprisingly high price of 10 lei per 1USD put the NBM *en garde*. Consequently, the results of the Bourse trading were canceled, and the official rate remained at the previous level of 6.40 lei/1USD. However, it was clear that the rate may well be at around 7-8 lei per 1USD at the initial stage, and later much will depend on the inflows of hard currency into the country, either in the form of foreign investment, or repatriation of currency as a result of export operations.

This higher nominal depreciation of Moldovan lei, along with very low level of inflation rate led to a depreciation in real terms, which happened for the first time since the introduction of the national currency. The real exchange rate index indicated in October 1998 a real depreciation of Moldovan lei against US dollar by about 15%, comparing to the level of December 1997 (calculated on monthly basis). This is believed to be a good evolution of the exchange rate, which exporters now should not be complaining about. Will they be able to take advantage of this remains to be seen.

The influence of present lei depreciation on the prices remains to be calculated, but it is clear that the major impact it will have on imported goods, while the prices of domestic products most likely will not raise more than 30% (depending on the import component in their production). Besides, since the majority of households have incomes in lei, which will not change much, it is believed that this will keep the domestic inflation in check.

An interesting aspect relates to the domestic interest rates. In order to maintain the present deposits and even to attract others the banks will have now to increase substantially the interest rates on lei deposits, which should be correlated with the depreciation of lei. Nevertheless the dollarization of the banks' funds will continue, at least till a mere stabilization of the exchange rate.

An alarming trend represent massive sales of hard currency of the NBM at the Moldovan Interbank Foreign Currency Exchange in 1998. In previous years NBM's transactions at the Bourse had a seasonality evolution, while during the period January-October 1998 NBM just sold considerable amounts of hard currency – almost \$123m. Stubborn decision of the Bank's management to defend the lei at all costs (which actually have been quite high) resulted in the end in draining of all own foreign exchange reserves of the NBM, thus at the end of October its net reserves turned into a negative value, while the gross reserves dropped to less than \$200m from \$366m at the beginning of the year.

Another critical aspect within the context of the official foreign exchange reserves reduction is linked with the need to service external debt, which implies transfer of big amounts in hard currency for the repayment of principal and interest. In 1998 Moldova has to repay more than \$215m for foreign debt servicing (including almost \$70m paid by the NBM to IMF). And all this is happening under an aggravating factor such as the considerable current account deficit of the balance of payments.

Since the country did not receive any loans from IMF and World Bank for almost an year, the NBM had to finance out of its reserves the repayment of principal and interest for the loans received from international finance institutions, foreign banks and others. Moreover, there are \$30m waiting to be fully redeemed in 1998 – the first Moldova's private placement through Merrill Lynch, i.e. the Eurobond, which was issued in 1996 for two years with a possibility to be prolonged till 1999. Of course, after the Russian "lesson" no one is willing to prolong these securities anymore. Thus, Moldova must have tough negotiations regarding a possible restructuring of the Eurobond debt.

The last IMF mission that visited Moldova in November reached a provisional agreement with the Government and NBM on a new program of economic policies, which if approved by the IMF Executive Board and successfully implemented by Moldova, will lead to the disbursement of the next \$35m tranche of the EFF, thus re-opening financing from the World Bank and other donors and creditors, including debt rescheduling.

In 1998 inflation rate showed a significant shrink comparing to previous years. In March, June, July, August deflation was observed, thus bringing the cumulative level of inflation for the period January-October 1998 to only 0.97%. However, taking into account the recent price increases, it becomes clear that the projected figure of annual inflation of 7-10% (NBM target) will not be achieved, and inflation rate would probably be somewhere at 13%.

Referring to the deflation phenomenon observed in summer 1998 it should be mentioned that it has mainly a pure monetary nature: the cash in circulation has shrunk considerably during 1998 – by about ¼. This happened due to massive withdrawal of lei from the circulation resulted from sales of hard currency done by the NBM at the Bourse out of its foreign exchange reserves.

The evolution of broad money did not follow exactly the same path as cash in circulation did, due to the fluctuations in the deposits base, both in local currency and in US dollars. The confidence of economic agents and the population in banks remained high during first half of the year, though it was quite affected by Russian crisis in autumn. While during the first half of the year people preferred high yields ensured by lei deposits with the banks, in autumn they started largely converting them in hard currency deposits.

As of end-September 1998 broad money has diminished by 13.2% (i.e. by 254m lei) comparing to the end-1997, and reached 1668m lei. This decrease is largely due in September when it diminished by 259m lei. The reduction of the broad money was conditioned by the decrease of base money – cash in circulation reduced by 23% and banks' reserves - by 32%. Deposits in lei fell by 19% at end-September, comparing to end-1997, while foreign exchange deposits grew (in lei equivalent) by 57.2%. Continuous dollarization of the banks' deposits had taken place.

Government's internal (and external) debt was accumulating further. Ministry of Finance, using also NBM's short term loans, continued to redeem previously issued state securities. Starting with June 1998 the share of traded securities in the total offer has decreased dramatically – from 80% in May, to 56% in June, further dropping to the level of

about 30% in October (out of these securities sold in October, almost 80% were 7-day and 14-day securities, which were launched into circulation on September 8, 1998).

Consequently, the Ministry of Finance faced the problem of shortage of funds needed for redeeming already issued securities, and any attempt to sell more bills would have led immediately to a critical increase in interest rates, which already reached almost 40% right after the Russian crisis began (luckily, a dangerous increase in interest rates was avoided).

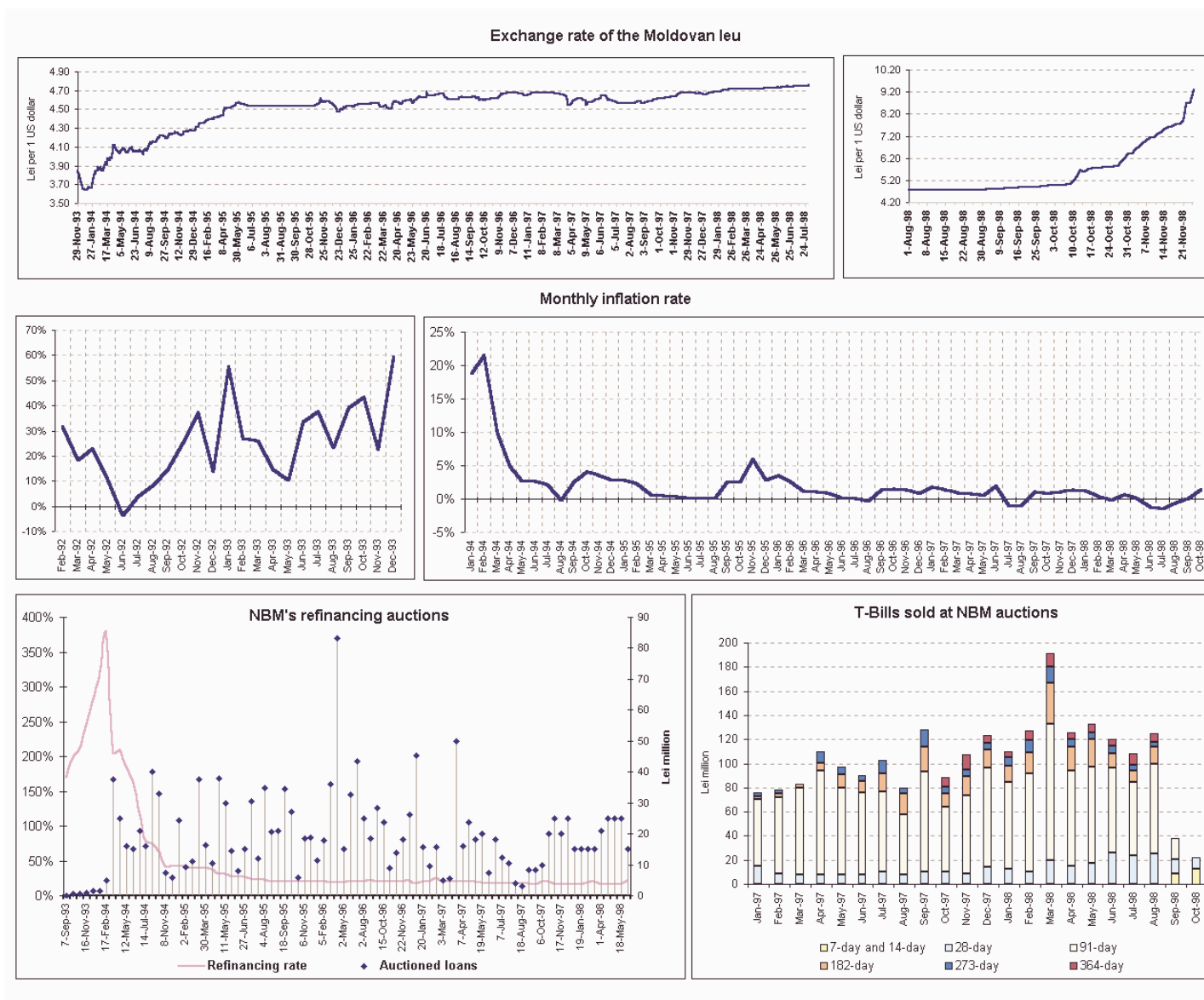
And the situation was expected to be such, because of heavy borrowing from the internal market done earlier by the Ministry of Finance for covering budget deficit. It became clear that increasing the amounts of t-bills sold on the primary market cannot last forever, and the first thing to blow could be the interest rate. What happened in Russia was from this prospective a good lesson for the Moldovan Government, showing that there is only one way to avoid the crisis – selling state securities only in the amounts needed for servicing the ones issued before, finding ways to reduce the budget deficit by cutting the spending, since finding sources for its financing has become impossible.

During the first half of 1998 nine refinancing auctions were held at which were sold 171m lei of credit resources, comparing to the 205m lei auctioned at the same period of last year. The NBM's annual refinancing rate has declined slowly to 16% in May 1998, however at the auction held on June 15, 1998 it jumped to 22.5%. This was a normal response under the circumstance of continuous increases of interest rates on T-Bills.

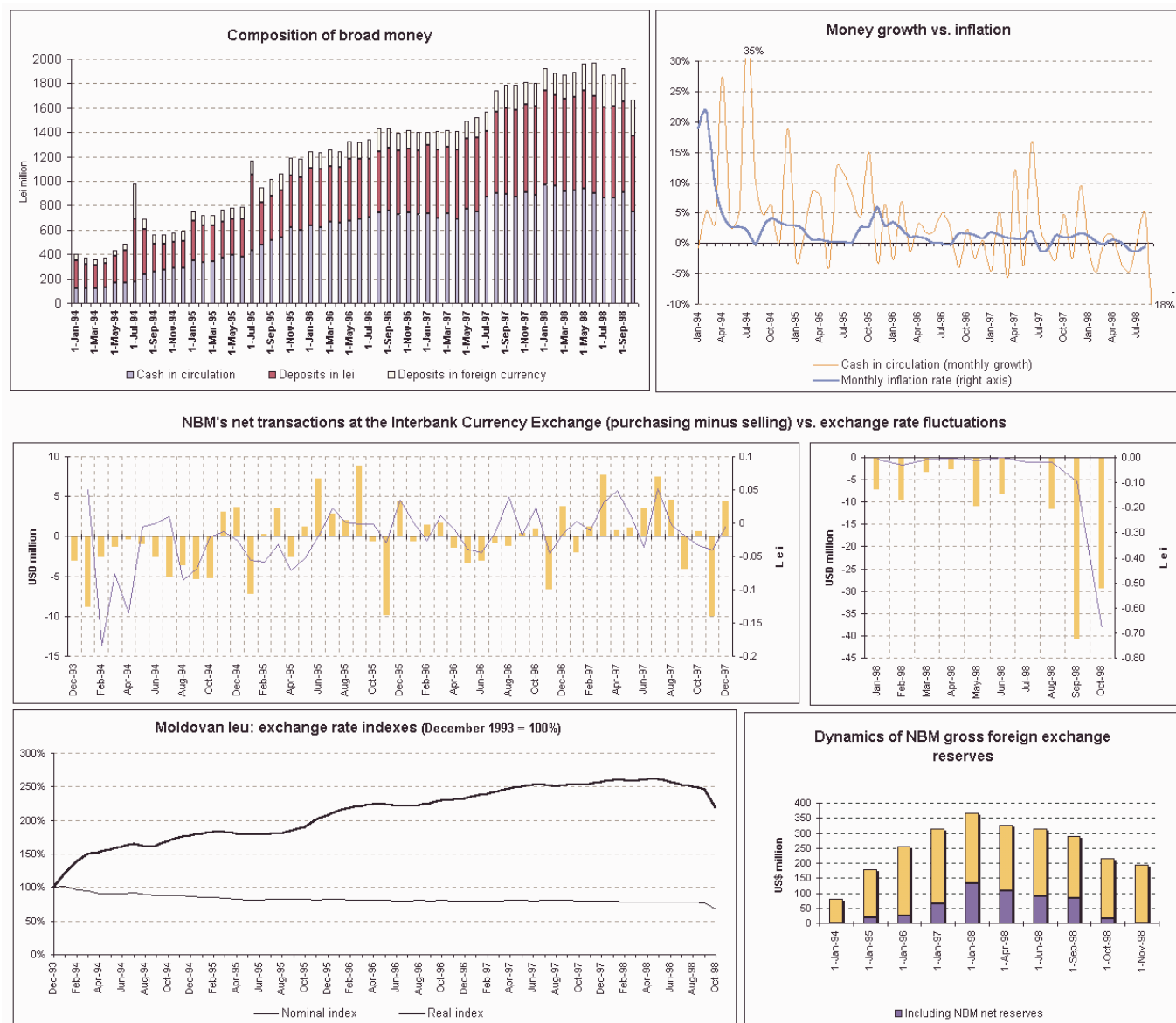
It should be mentioned, that this was the last refinancing auction, because afterwards these auctions were totally replaced by the Lombard facility and open market operations - Repo agreements. Consequently, large discrepancy between the refinancing rate and T-Bills interest rates was cleared. This discrepancy earlier allowed banks to buy cheap credit resources at credit auctions and then use them for buying T-Bills (i.e. financing state budget deficit), thus getting easy and risk-free profits.

During June-September 1998 banks received credits worth 202m lei (Repos – 84.4m lei, and Lombard facilities – 117.4m lei). Banks' overall credits to the economy topped at 1130m lei. The lowest volume of loans was granted in the month of September 1998 (55m lei). This happened because of the reduction of temporary available funds of commercial banks, which engaged in buying hard currency in the market, as well as reluctance of economic agents to take loans.

Overall, assessing the financial situation in Moldova, especially in the context of the crisis in Russia, it is clear that the internal stability on the financial market was maintained till November 1998 on the account of NBM's hard currency reserves, which supported the leu and eluded a default of the country in terms of foreign debt servicing. Among other factors which helped to avoid a major crisis after August 1998 were: a more or less stable banking system, relatively low level of country's private commercial debt, and relatively limited participation of foreign investors in buying state securities. Still, on the other hand, there were a number of persisting critical problems, such as: huge budget deficit, large current account deficit, high level of foreign debt, lack of external financing and others. Thus, in order to make the macroeconomic stability lasting it is obvious that the Government must optimize spending, reduce the imports, and foster the exports, by fully implementing long-awaited reforms in the real sector of the economy, backed by the international financial institutions.



2. National currency: successful story?



3. Fiscal policy: missed chances

The state and fiscal policy

Public finances are composed by the revenues and expenditures of public administration, which are the public or state authorities. Their main economic goal is to produce services having no buying / selling specifics (e.g. which are not sold and do not create a price) and to make a redistribution of revenues generated by obligatory payments (like taxes and social contributions).

State determines the social-economic and financial situation, in the country through its fiscal policy. Fiscal policy success depends on the existing judiciary system and assumes the superiority of law in the relations between different subjects of social-economic activity.

For the normal functioning of market economy the state has to ensure maintenance of financial discipline. Four simple rules must work: i) the buyers observe agreements and pay for delivered goods; ii) debtors do not neglect credit agreements and do reimburse credits; iii) taxpayers pay taxes; iv) companies cover their expenditures from obtained incomes.

It should be noted here that the fiscal policy was developing and consolidating, being an important instrument of state economic policy.

Republic of Moldova: fiscal policy evolution in the '90s

The Republic of Moldova managed to formulate its independent fiscal policy after obtaining the independence in 1991. Consolidation of fiscal and budget systems, as well fiscal policy, took place after the national currency introduction in November 1993, in an environment of reducing of inflation and interest rates.

Two periods of fiscal policy evolution should be distinguished:

1991 – 1995: period of evaluation of the legacy received and of adaptation to the new economic environment by modifying the existent legal framework. Since 1992 new taxes (applied in market economies) were introduced like, VAT, excises, road fees, customs duties and so on. The principles and methodologies of calculations were modified for the existent taxes.

1996 – 1998: period of fiscal and budget system reform, accompanied by deepening of budget crisis.

The constitution of the budget system – Law On Budget System and Budget Process – was adopted in 1996, which is the base for public sector functioning.

The apogee of reforms in this domain was reached in the period of 1996-1998, when the Concept of Fiscal Reform was adopted and the first chapters of Fiscal Code were elaborated and implemented.

The concept of fiscal reform had the following objectives:

- Contribution to the investments attracting (both internal and external) for ensuring further economic growth combined with creation of new working;
- Ensuring the equity of the fiscal system;
- Ensuring revenues necessary for financing of public programs and services;
- Simplification of the system;
- Ensuring the efficiency of the fiscal administration through consolidation of the existing structure, modernization of own facilities, automatization of data processing, improving the methods of collecting and controlling the fiscal legislation observance.

3. Fiscal policy: missed chances

In order to achieve this objectives the reform was divided in several phases:

1. Unification within the Code of all laws on taxation of incomes of individuals and economic entities and of all administrative provisions;
2. Reform of VAT system;
3. Improvement of land and real estate taxes;
4. Modernization of methods used by fiscal administration for tax collection;
5. Examining of other revenue sources in order to reduce or eliminate inefficient taxes which stop economic growth in Moldova.

In spite of realized measures of fiscal and budget systems consolidation and implementation of an adequate policy in this sphere, we see now that the results obtained are far from the forecasted ones.

There are a lot of explanations here. Certainly, in 1994 – 1995 monetary policy was tight, serving the consolidation of national currency and the creation of a credible environment with respect to the national currency and thus contributed to a relative financial stabilization. Even more, positive tendencies of budget deficit reduction were registered. These tendencies should have been immediately supported by structural reforms in such key domains like *energy sector* (this sector has impacts to all sectors of economy and to the economic indicators at micro and macro levels); *agriculture sector* (in that period at the political level and the halting of reform was accompanied by high climatic risks which generated financial and material distortions in this sector); *social sector* (framework inherited from the Soviet period did not change and the costs for this structure were continuously growing; a delay in introducing pay services in education, health care were generating year by year a 30 % deficit of financial resources need for this sphere.

In 1996 the fiscal policy should have been dominant in the economic state policy and monetary policy must have been adjusted to the fiscal policy and real sector's requirements. And the beginning of 1996 was in fact quite promising: several important laws were adopted such as laws on budget system and budgetary process, on public debt and state guaranties, the concept of fiscal system reform, law on bankruptcy, the process of treasury system implementation was initiated, new budget classification and new accounting standards were under elaboration, the state securities market consolidated. Economic indicators for first 6 months of 1996 showed tendencies of growth in the real sector of economy and of macroeconomic aggregates. Hence, the premises were creating for transposing the focus from the monetary policy towards the fiscal and budgetary policy.

But 1996 was a year of elections and the elections need money, including public finance. In that period a lot of decisions were adopted, and their negative effects persisted till present: the government decision on netting out operations which generated chaos in the national economy, individual and branch tax exemptions, technical credits to the agricultural sector. At the same time the structural reforms in the economy have been suspended. Energy sector, agriculture sector and social sphere became an unsustainable burden for the budget.

It is known that Moldova has liberalized the internal and external trade relations. But this process was not completed and is running slowly. In the conditions of insufficient internal resources the state assumed the coordination of tariffs in the energy sector which generated financial blockage in this sector as well in the rest of the economy. Undertaking of the 140 million dollars debt in 1996 and recent undertaking of another 90 million dollars debt will burden the budget system for at list the next 7 years. Moreover, the reimbursement mechanism funds of withdrawn from the budget is not transparent and is not sustainable.

Liberalization was also hampered by the introduction of a huge number of licenses and restrictions of other nature applied for export transactions. At the same time, a facile import

regime was granted to some economic entities. Hence, through the Free Economic Zone, Moldovan Mitropoly, Olympic Club and others a traffic corridor for merchandise was created, of which other partner sides benefited from, thus avoiding fiscal legislation of Moldova and contributing to an unfair competition on the Moldovan market.

Acceptance of barter transactions after the disruption of economic relations with ex-Soviet countries during 1992-1993, and there further development on the domestic market in the next years has led to a diminution of the role of financial system. An economy which claims to be based upon market relations must be based upon Goods-Money-Goods relations. At the initial stage in Moldova the element of *money* is neglected, afterwards being partially substituted by *quasi-money*. A significant part of inter-payments was effected through mutual clearing which led to financial frauds. Until present there haven't been found other alternative instruments of clearing the financial blockages.

Another cause could represent the huge component of underground economy and of group interests. These phenomena, which have been frequently determining the adopted decisions on state level, delayed implementation of initial ideas, and also created a negative image towards the fiscal reform in the Republic of Moldova, that in its turn halts the investment activities.

Because of lack of a medium term economic policy, the fiscal and budget policy could not have been drawn up according to the demands of transitional economy. Government's programs Sangheli '92-'94 and '94-'97, Ciubuc - 1 did not draw a medium term economic policy but only a package of operative measures, or some mechanisms, which could not have resulted in a economic stability or growth. Moreover, they had a clear declarative content, since these decision, which were adopted after the approval of government programs, often were in contradiction with the programs themselves.

Unfortunately for the fiscal and budget policy there were suspended the reforms in the following sectors: energy, agriculture, education, health care, social assistance, which needed an important part of public financial resources. Due to the scarcity of funds, these sectors became a big burden for the budget, also creating financial blockages and rising debts on the expenditure side. Delays in pension system reform, non-transparent execution of the social insurance budget, have generated a chaos, and have also been a burden for state budget.

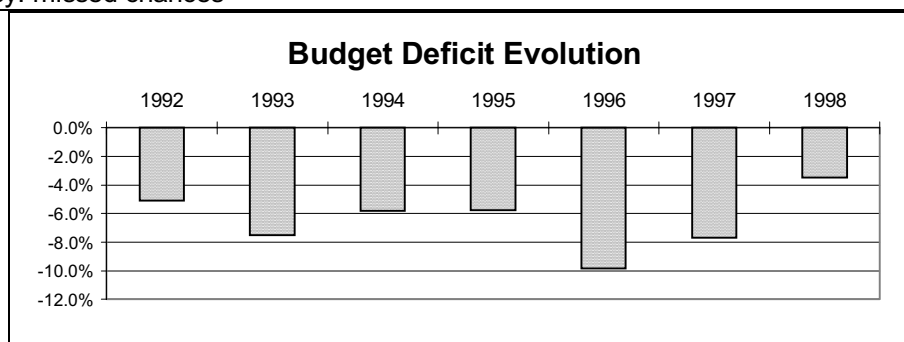
All above mentioned are the motives which transformed the employees of the budget sphere and pensioners into *state's creditors* since they can not get their salaries and pensions.

During this period were missed the possibilities of privatization of several objects of the communications and thermo-energy sectors, of the wine and tobacco industry, which could generate additional income for the country's budget system, and also more benefits (or at least avoidance of losses) for the economy as a whole.

Economic reform in ever economy would fail if it is not accompanied by juridical reform. Although the reform in this field was declared, it still remained as an isolated field, which is poorly reacting towards the reforming processes in the society. This fact determined lack of legal mechanisms for solving the some administrative, financial and organizational disputes. Corporate management practically doesn't function, it is difficult to avoid and eliminate financial frauds; overlapping of functions and lack of responsibility with respect to the Law generate financial crimes, fiscal evasion, non-compliance with terms of agreements and business contracts, etc.

Budget deficit is a starting point in estimating the fiscal and budget policy implemented by the state. In conditions of transition towards market economy this indicator is being influenced by many factors.

During the transition to market economy the Republic of Moldova is facing the problem of high budget deficit. So, starting from 1992, every year onward a budget deficit is recorded, fluctuating between 5.1% and 9.8% of GDP.



Note: According to IMF methodology the 1996 budget deficit is 7.0 % in GDP. Since 1997 the new budget classification was implemented and the volume of the budget deficit is closely to that methodology

At the initial stage the main causes of high budget deficit are the following: sharp and lasting economic decline, to a large extent caused by brake up of economic links and/or establishing of non-economic relations with former partners, as well as high rates of inflation.

Problems, which emerged at the initial stage, have already generated new burden for the budget for the next period. Hence, the decline in production sector led to a need in higher subsidies (both direct and indirect) for enterprises and population. It also created a long range of tax exemptions, decreasing fiscal revenues. Any tax exemption is supposed to stimulate the branch of industry to which it is applied. Hence, in this environment the activities that are not liable for taxation are flourishing. As a result even in countries with economic growth budget revenues may drop, since the growth takes place on the account of tax-exempted sectors.

Besides, changes in the fiscal system create difficulties for taxpayers in accommodating to new conditions. Tax evasion and non-payments to the budget grew considerably. The phenomenon of “forgiveness” for some economic agents by the Parliament created the system of non-contributions to the budget by the entities that previously honored their debts.

During the transition period budget expenditure increased: subventions were growing as well as expenses for internal and external debt service by the state. Crediting of enterprises by the budget also increased. Lately the increase in budget expenditures was also induced by previously accumulated expenditure arrears.

The increase in the last years of the state debt, serviced by the Government, was caused also by the needs to finance the budget deficit, and it leads to the growth of expenditures required for debt service. Thus, share of these expenditures in the volume of deficit has risen from about 40% in 1994 to almost 60% in 1997, as a result of growth of state debts serviced by the Government from 33% of GDP to 49% for the respective period.

Budget deficit financing is effected through combining internal and external sources, both being used in the same proportion.

Internal financing is done by receiving credits from the National Bank and by issuance of state securities. Along with the development of the securities market the structure of internal financing has changed, being reoriented from direct NBM lending to the Government during 1992-1995 towards attracting credits from the NBM against state securities during 1996-1997. Moreover, the Budget Law for 1998 foreseen that NBM would not grant any loans for financing budget deficit.

Thus, financing through state securities has become a permanent instrument for budget deficit financing. Interest rate lowered 2-4 times during 1995-1997, easing the pressure on budget.

External financing of budget deficit utilized in recent years has contributed to a rapid growth of state external debt, although the costs are relatively low (comparing to internal financing).

Budget deficit is a tool for measuring the impact of fiscal policy on the economy. Public sector deficit affects domestic savings and diminishes future living standards in the following ways:

domestic investment plummets, foreign debt raises, leading to further drop in national income. High levels of public debt and budget deficit affects both investment and economic growth.

International practice and theory suggests the following criteria for financial stability: low inflation level, a ratio of state debt to GDP not exceeding 60%, budget deficit below 3% of GDP. Otherwise the deficit should be gradually reduced to reach international acceptable levels.

During the transition a budget deficit is inevitable, but its maintenance for seven strait years requires its reduction to 2-3 percent of GDP in the nearest future. This is especially true when having an excessive level of state debt, when its further growth may seriously affect state finances.

Further development of state securities market, refusal from NBM credits, and moderate external financing of the budget deficit are the objectives that will determine the budget deficit financing for 1999-2000.

High cost of internal loans leads to a rapid increase of domestic debt servicing expenditure. Thus internal financing of the budget deficit should be determined by the necessity of reduction of domestic interest rates.

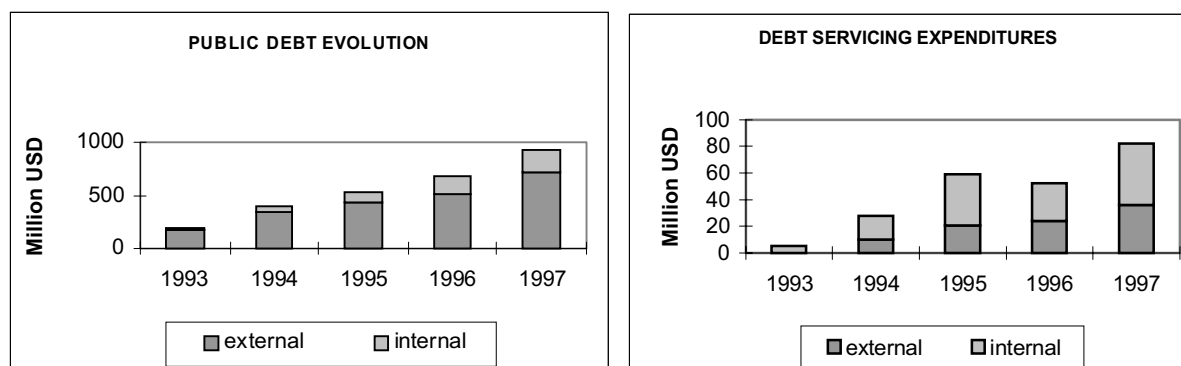
The policy of financing from domestic sources should be based not on budgetary needs, but must have the objective to reduce the negative consequences of foreign debt service burden on economic growth. Budget loans will be attracted from the to non-banking sector, drawing in the population and other small investors. After 1999 this will become the principal source of budget deficit financing.

The policy of attracting foreign funds will be oriented towards the aggravation on foreign debt indices: its ratio to GDP (in 1997 it was 61 of percent), ratio of foreign debt service to exports of goods and services. Following these considerations the newly attracted credits should be used for structural and sector changes.

Since the repayment of foreign debts is enlarging in the following years, the net foreign financing will became insignificant, or even negative. While honoring all the foreign payment requirements, the share of primary deficit (deficit without state deficit service) will remain at the same level, taking into account the decreasing budget deficit.

A new problem, that may become a very serious one, is the admission of local budget deficits. Their drawing of commercial credits at local level may cause a debt crisis on territories, impacting the central budget. Therefore, the local financing policy should be strictly coordinated by central authorities – the legal framework should be revised / created.

Public debt. Since 1992, with first budget expenditure financing problems, the public debt accumulation started. The initial public debt was accumulated through direct credits from the NBM, while foreign debt accumulation started in 1992.



Since 1998 the NBM does not offer credits for budget deficit financing, with the exception of short-term loans (up to one year).

The majority of countries with market oriented economies consider the secondary market for securities as a sound economic tool for budget deficit financing. There are cases (Russia, for

3. Fiscal policy: missed chances

example) when these tools insufficiently conducted and monitored create a so-called *pyramid of state securities*. This pyramid is also known as the *mechanism of debt self-reproduction* and consists in:

Increase in primary budget deficit > increase in the amount of new loans > public debt raises > interest rate soars > expenditures for debt service grow > general budget deficit expands > need for new credits > new increase in the public debt > expenditures for debt service grow > etc. > default...

The Republic of Moldova has huge foreign debt accumulations. Unfortunately it was not used according to the rule *one ban spent today brings two tomorrow*, but according to *let's spend today, they are gonna give us more tomorrow*. The absence of the law on money laundry and the tergiversation of its adoption cannot be justified.

Securities market. Starting April 1995 Government, represented by the Ministry of Finance commenced the issuance of state securities for covering budget deficit. First issues were at around 90% annual interest rates. Interest rates have gradually diminished reaching 18-20% by end-1997. Under these circumstances budget deficit financing through this mechanism was justified.

However, beginning with 1998 the Government's financial situation has deteriorated considerably, the interest rates went up reaching 40%, although the low level of inflation and leu's stability did not serve as a basis for lack of confidence.

In the conditions of internal and external financial crisis this phenomenon can faster lead to a default of the country, and therefore a collapse of internal financial market. Along with continuous disturbances in the national economy the state securities market became in 1998 a burden for the budget and for the banking system. Furthermore, in September-October 1998 this situation lead to a need in a direct crediting of the Government by the National Bank which was actually done.

Because of the financial crisis in the world Moldova lost it's opportunities to borrow from capital markets abroad, by issuance of Eurobonds. Russian crisis aggravated even more the situation on the internal securities market, Moldova found itself very close to a default. It is impossible now to regain the confidence of the investors and at the same time it is dangerous for the Government to issue securities at any cost (which actually happened in Russia before the crisis). This could lead to acceleration of the process of self-reproduction of debt resulting in the end with a default of the country.

During 1999-2000 the policy regarding the state securities market should be: i) oriented towards redemption of issued T-Bills and T-Bonds; ii) utilized as a mechanism for reimbursement of loans received from NBM during 1992-1998.

Fiscal policy in 1998

The year 1998 will be year of big endeavors, including tough acceptance of the simple truths of economic realities such as: that we can not consume without paying; nobody is willing to support or to credit someone else forever; it is impossible to continuously accumulate external debt without having the capacity to reimburse it; market mechanisms imply revenue distribution according to individual and group performance; unity and social solidarity are easier to realize in a society which is doing well; in open systems performances are estimated in relative terms (it is important not only what we are doing, but what our neighbors are doing).

This is an extract from the introductory part of the Economic Survey no. 1 issued in July 1998 by CISR. These phrases have become even more actual after the world financial crisis, and especially the Russian crisis from August 1998.

Consequences of this crisis for Moldovan economy, especially for the budget, are difficult to be expressed in figures. It is though clear that: Moldovan exporters have to store the produces commodities, to supply the goods without a certainty that they will get paid for this, to halt the

production of goods for the CIS markets, especially for Russia. Costs of this phenomenon can generate soon a rise in unemployment and much higher social costs.

The budget will not receive those revenues previously forecasted, referring to the VAT (VAT with Russia is calculated on the basis of the country of origin), excises, income tax.

However, there are also other causes (other than crisis related) which block the Moldovan exports: introduction of an import surcharges by Russia and Romania. Thus, Moldovan production suddenly became non competitive. At the same time imports into Moldova are rising, because the import regime is quite liberal, while Balance of Payments has persistent problems. In the end state budget has losses, or simply speaking the budget expenditure arrears are increasing.

Suggestions for the fiscal policy

In order to implement a successful fiscal policy it is extremely important to delimit the customs territory of the country. "Transparency" of Moldovan borders, especially of the Eastern borders, the liberal regime for importing goods subject to VAT and excises, generate financial losses both the national economy and budget system.

It is almost suspended the accounting reform. This situation contributes to financial frauds, embezzlement and room for different kind of "settlements" between tax payers and financial and fiscal control inspectors. In case if till mid-1999 new accounting standards will not be fully implemented, the Republic of Moldova risks to loose its budget system.

Along with the implementation of the new pension system which provides for introduction of personal accounts, it is appropriate to increase the payroll tax from the individuals (from 1% to 5% for the initial period). This will mean that individuals would be interested to contribute to the Social Fund. Secondly, it would eliminate double accounting which is present at the economic entities. Individual would be interested in showing the actual rewarded amount in the accounting papers. At the same time the contribution rate paid by economic entities can be reduced by 5 percentage points.

Any fiscal policy, as an element of state's financial policy, will fail, until the non-financial relations persist between economic entities and budget system, or between economic entities themselves. Hence, it is urgently needed to eliminate barter transactions, netting out operations, and payments in kind. Economic entities have accommodated to this types of businesses, managing to avoid payments to the budget system.

Although introduction of VAT in the Republic of Moldova is considered to be a success, a step towards the market economy, still the VAT, as it exists in Moldova, is a serious disadvantage for the economy. The huge list of tax exemptions, of legal acts regarding VAT, cause chaos in the accounting statements and contribute to the irresponsibility and incompetence of control bodies. Moreover, they generate considerable fiscal evasions. It may be appropriate to suspend the VAT provisions for 6-12 months and to clear up the situation here and simplify the VAT system. It may be suggested to temporary reintroduce the turnover tax.

For a short period of time it would be advisable to introduce a surcharge on imported goods which would halt the inflow of goods. Especially because the neighboring countries have introduced such surcharge already. This step would contribute to a diminution of trade balance deficit in a short run.

A number of discussion take place on public finance: existing tax system, existing system of redistribution through the budget. All ideas coming out of these discussion have their pros and cons. But speaking about public finance, and not only about this, we must be guided by the famous assertion of the President Kennedy: *"Don't ask yourselves what a country can do for you, but what you can do for the country."*

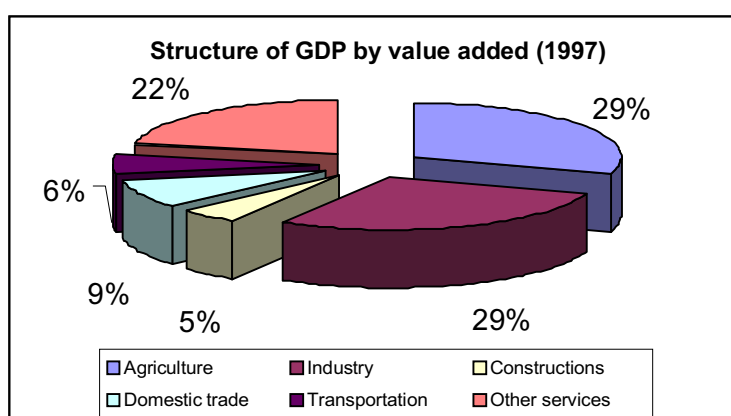
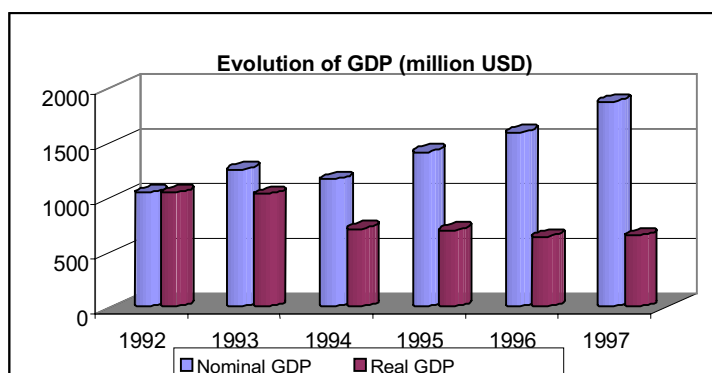
4. Real sector: official and underground economy

4.1 Gross Domestic Product

Moldova's transition towards a market economy is characterized by a deep economic decline in the real sector of the economy, a dramatic fall in production, a rising inflation and growing unemployment. During 1992-1997 statistical data show a record (37%) shrink in real GDP and 64% compared to 1990, reaching 8.7 billion lei. GDP per capita is also at lowest level among CIS countries – 2.4 thousand lei (USD 515). Another 5-10 % fall in real GDP is expected for 1998.

Opening of Moldova in terms of international trade led to an equalization of domestic and external prices, resulting in a smaller GDP fall calculated in USD (less than 40% since 1990). The evaluation of GDP in US dollars even in nominal terms showed an increase by approximately 80%, reaching USD 1,878 million.

GDP structure (by added value) divided by economic sectors is relatively stable, with an emphasis on the agro-industrial sector. Services' share is continuously expanding.



Structure of GDP by expenditures (%)

	1992	1993	1994	1995	1996	1997
Final	57.5	55.9	75.4	82.9	95.8	96.6
Including government	5.4	15.9	22.9	27.1	27.2	26.1
Gross capital	59.8	55.8	28.8	24.9	24.4	24.2
Net	-17.3	-11.7	-4.3	-7.8	-20.2	-20.8

GDP by expenditure components displays a discouraging tendency of final consumption growth (from 57.4 % in 1992 to 96.6% in 1997). The index for 1998 are even more frightening, constituting 123%. There are two causes of this phenomenon. On one hand, the state lives on borrowed money, paying little attention to revenues. On the other hand, it is common for most economies that the population seeks to declare its expenses and to hide its incomes, contributing to the underground economy. Our estimations show an increase in the share of shadow economy reaching 55-60% in 1997. Starting 1995 the whole economy (including unofficial) shows a growth.

State structures became more costly for the society in the past six years. The state expenditure share in GDP grew 4.8 times (from 5.4% in 1992 to 26.1% in 1997). The fact that the share of state expenditures in total expenditures grows is also alarming. While in 1992 it constituted 9.4%, in 1997, when the role of the state diminished, the share of state has come already to 27%.

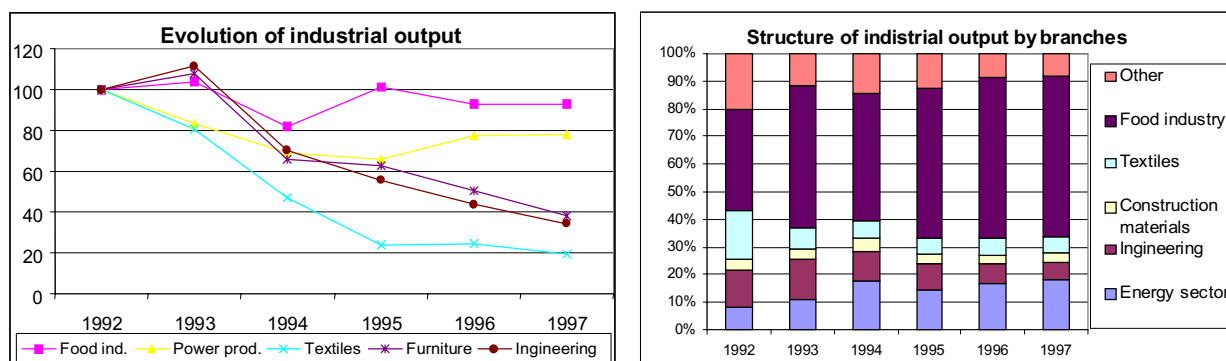
This phenomenon is accompanied by a dramatic decline in the gross capital formation (from 59.8% of GDP in 1992 to 24.2% in 1997). This will imply in the long run an economic decline.

Net export rate varied from -17.3% in 1992 to -20.8% in 1997 (See Chapter 4.5), with its minimal value in 1994 (-4.3%).

4.2 Industry

The evolution of industrial production in 1992-1997 shows a 36% reduction in the gross production, and the decline varies by sectors. Thus, construction machinery production fell by 66%, furniture production – by 61%, textiles – by 80%, power – by 21%, and the food production – by 36%. During first three quarters of 1998 the industrial production shrank by 5.7% compared to the same period of 1997. In September 1998 a sharp drop in industrial production took place (32.5%). The production was reduced in wood-proceeding enterprises by 17.3%, light industry – 9%, construction materials – 10.6%, sugar – 13.4%, bakery products – 11.6%, meat – 28.3%, wine – 21.4%. The causes of that reduction were: the impact of the Russian financial crisis (decline in demand), VAT levying on raw goods, materials, spare parts, as well as double taxation of exports to Russia and Belarus.

The structure of industry has been altered in the most unfavorable way: the share of food processing industry rose from 36.1% in 1992 up to 58.2% in 1997, of the energy sector – from 8% to 18.4%, while it declined from 18% to 5.8% for the light industry, and from 13.6% to 5.8% for engineering.

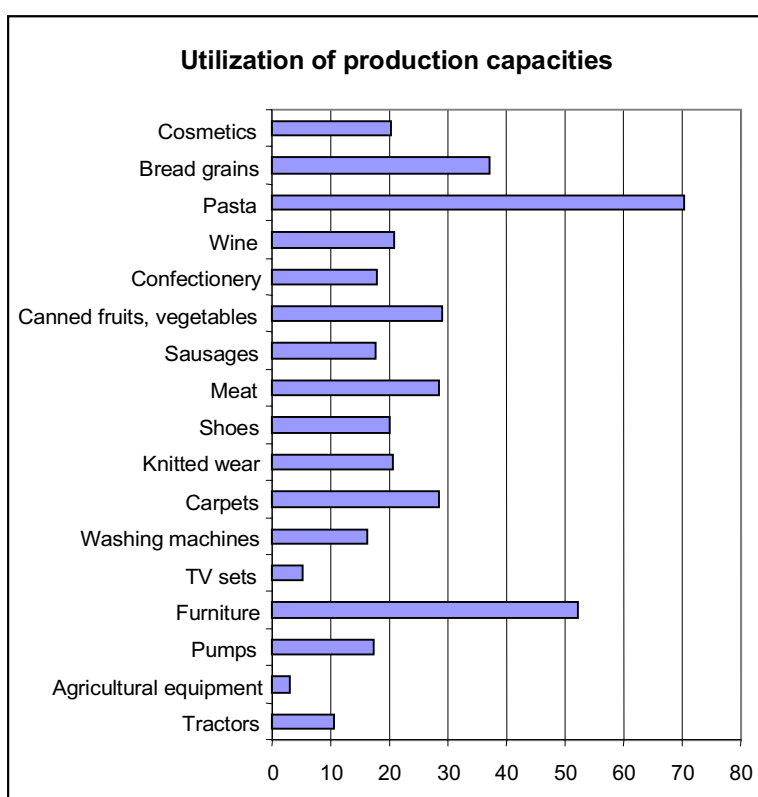
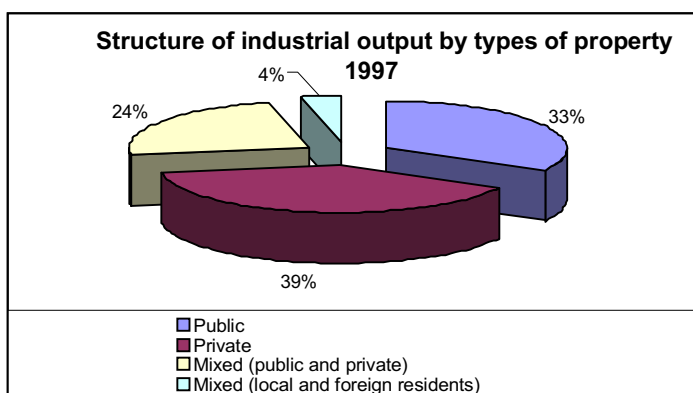


The utilization of enterprises' production capacities diminished significantly as a result of considerable reduction of industrial production. More than two-thirds of enterprises are producing now only at a level of 10-20% of their capacities. It is clear that complete restoration of those obsolete production capacities, which are producing non-competitive merchandises, is impossible during the transition to the market economy.

The setup of market economy structures and the creation of new productive formations changed the structure of industrial production by types of property. Hence, the share of the private sector in the industrial output reached only 38% in 1997. Presumably, this would imply the beginning of an increase in overall efficiency of the industry. In 1992-1998 the labor productivity in this sector experienced a slight increase (11%).

The increase in energy intensity of industrial production is of a continuous concern. In the conditions when technologies virtually do not change much, or there are insignificant changes towards decrease in production of energy-intensive goods, the actual growth of the energy intensity of industrial production may well be explained by the increase in stealing of energy, which in the end has negative implications on prices.

As a way of improvement of industrial sector could serve the privatization and continuous restructuring of enterprises, conversion of historical debts into shares, implementation of corporate management, promotion and support policies for new competitive hi-tech and energy-efficient technologies, stimulation and promotion of exports, and the negotiation of export quotas with developed countries.



4.3 Agriculture

Agriculture and related industry is still a vital sector for the economic and social life of the country, accounting for almost 40% of GDP, three quarters of export and employs over 43% of the national labor force.

Reforms in agriculture, which include privatization of land and restructuring of agriculture constitute a fundamental part to accomplishment of a global transformation in Moldovan economy.

Almost all measures within the agrarian reform have brought to the present situation. The reform in agrarian sector lag behind, and causes negative reactions to:

- Price liberalization of agricultural products. In January 1992 in Moldova were officially liberalized prices on most of the consumer goods. But the underdeveloped domestic marketing system and the low competitiveness of the domestic products still keeps most of their prices considerably below the prices for import.
- Price liberalization on inputs, which led to the increase prices on key inputs up to international levels prices and created considerable changes in production process and export patterns;
- Reduction of subsidies before the creation of institutions and legal framework on agricultural market which led to diminished consumption of fertilizer, purchase of high quality seeds; reduced investments for development of rural services despite the extremely low standards of living in the areas; insufficient access to credits due to high interest rate.

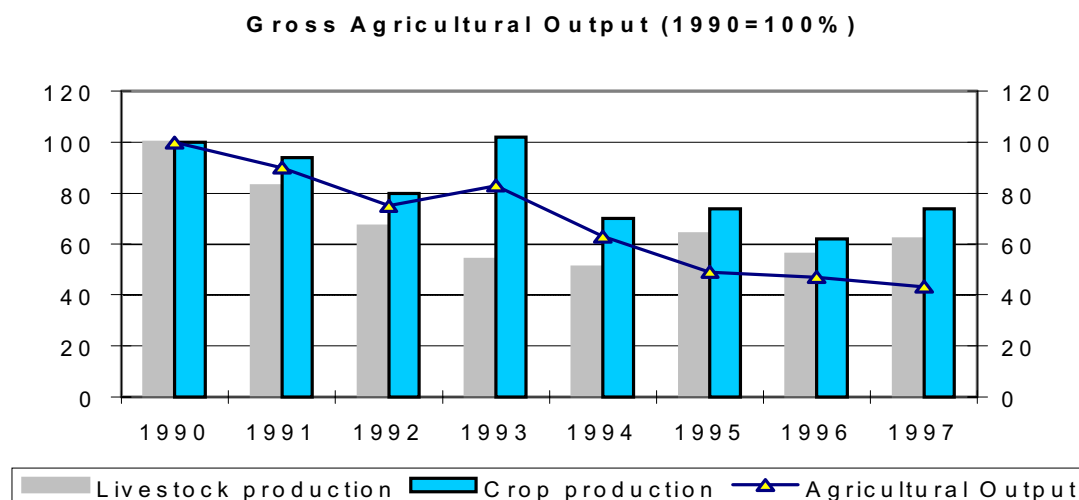
Although, the mechanism mentioned above has been proved for long time in different countries with market or transition economies, in case of Moldova, mistakes have been made in terms of timing, vision, pace, and in reality perception in reaching the market stability.

The quick shift without any strategy from an excessive command based economy in agriculture to an excessive liberalization can not assure the economic efficiency, with the exception of infusion of big investments, considerable discrepancy in population's incomes and deepened poverty related to Moldovan situation.

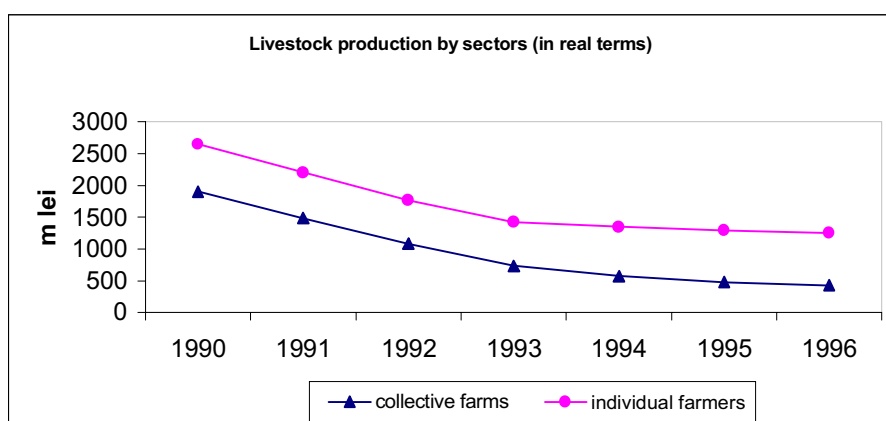
Since 1991 the changes in agricultural production have been mentioned. They were mainly influenced by lost of the traditional markets as a result of the collapse of the social system and appearance of the new private structure (individual sector).

Since independence, total agricultural output declined by more than 44% compared to pre-transition levels, with crop production falling by 38% and livestock production by 53%. A change in the product mix was observed as the share of crop continuously increased since 1990 opposite to decrease in livestock production. As a result, the production of food halved and the local consumption started to be satisfied by the imported products.

Crop production prevails in the structure of the agricultural production. In both, the large scale and individual enterprises the level production of crop is higher than of livestock one.

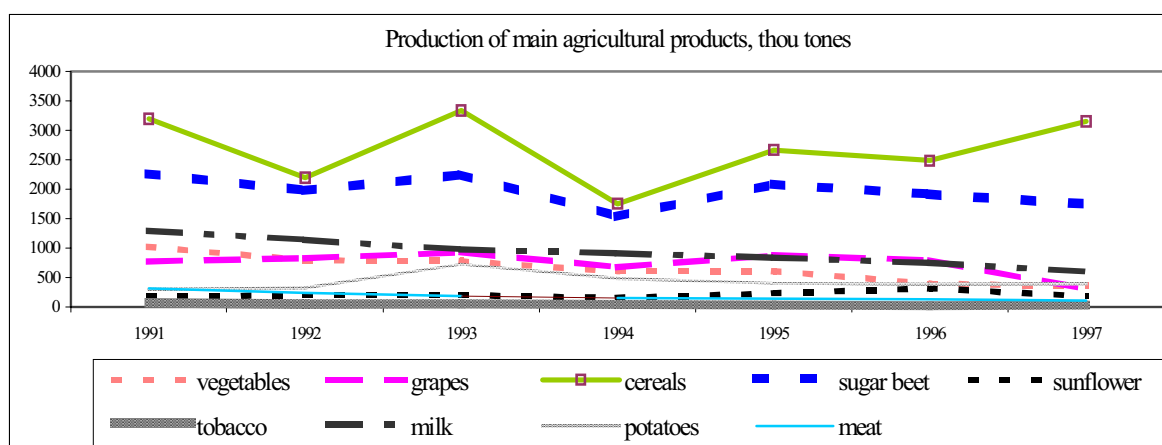


The decline of livestock production is caused by the reduction of livestock by 60-70% as compared to 1990 level and the liquidation of cattle and pigs farms. In the same time individual sector showed better results in livestock production than collective farms.



For the period of 1991-1997 there has been a sharp increase of grain production and insignificant increase of sugar beets, sunflower, and potatoes due to their relative simplicity in cultivation and commercialization. The share of milk production remained stable, although the production of meat, tobacco and vegetables decreased considerable.

The lack of financial resources, reduction in mineral and chemical fertilizers use (from 136 kg per ha in 1991 to 11 kg per ha in 1996) as well as bad weather conditions during the last years led to a considerable reduction in average production per hectare of most of the crops.



Average yield per ha, (in quintal)

In 1997 the production of vineyards per ha decreased by 40%, the production of vegetables by 52% compared to the 1991 level.

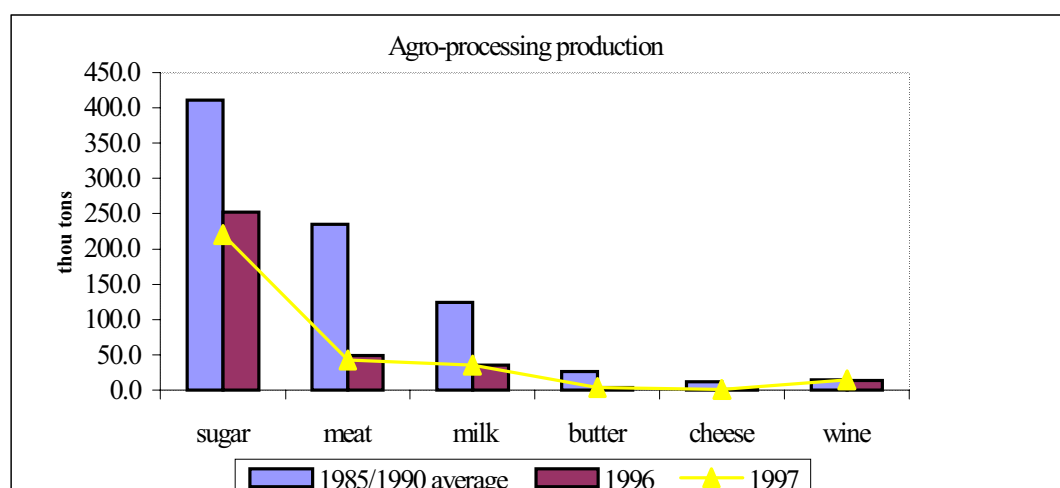
A reduction of the surface used for labor

	1991	1992	1993	1994	1995	1996	1997
Fruits	44	31	61	37	37	34	62
Vegetables	121	102	100	83	76	58	63
Grapes	45	49	54	40	50	45	18
Cereals	37	28	37	21	29	22	33
Sunflower	13	15	15	11	14	14	10
Sugar beet	283	239	271	184	230	228	247
Potatoes	62	56	102	349	68	57	63
Tobacco	20	15	16	15	14	11	13

intensive crops was mentioned. Thus, during the transition period the vineyard area in Moldova diminished by 70 thou ha down to 164 thou ha in early 1998. There is continuous decline of the surface sown: some 9-11 thou ha per year taking into account that only 500-700 ha are annually replanted. The surface sown with orchards started to decrease in 1994 and the decrease will continue because the orchards are no longer being renewed and trees are aging significantly. An important problem to solve is orchard renovation. Their age indicates, that a decrease of fruit production can be expected in the nearest future: 10% of fruit trees are older than 18 years, 20% are 13 to 17 years old and only 13 % are younger than 3 years.

Changes have taken place in land ownership, followed by significant structural change of transfer of production to the individual sector, which showed 140% increase compared to 1990. These changes have linked to an essential increase in the share of individual sector in GAO: from 20% in 1990 to 51% in 1996. The 21% of land in private ownership produced more over a half of all agricultural output, while large scale enterprises produced only 35% of the 1990 level.

An enormous food-processing industry was built in Moldova with the objective to supply on a guaranteed market in Soviet Union. Barter and other non-cash modes of payment, massive tax and wage arrears, growing mutual indebtedness between commercial agents – all of this could characterize the present situation in agro-industrial sector. Since independence almost all processing plants have been privatized and the majority of them were transformed into Joint Stock companies with practically 100% of private capital. At the same time a new sector of processing industry is being established – on the basis of private ownership and small size and are meant to provide services to private farms and other small producers of agricultural raw material.



During transition period the food-processing industry confronts difficulties and faces new challenges: no centralized provision of raw material, fuel, packaging, equipment and spare parts. The production of agro-processing industry dramatically declines: in 1997 the total meat production has declined 5 times, milk- 3.4 times, sugar – 1.8 times, butter – 7.7 times as compared to 1985/1990 average.

The wine production faced a considerable decrease during 1992-1995 (about 40%). In 1997 production reached the 1985/1990's average level. Currently, Moldovan wineries are in very bad situation; most of them are working at 30-40% capacity, some are even closed and their employees are on imposed vacation. The total production of processed fruit and vegetables has declined by 45% as compared to 1985/1990 average. There are 16 fruits

and vegetables processing plants currently operating. Almost all plants had problems with their supplies of raw material. With the exception of apple processing all other fruits and vegetables are processed according to the availability of raw material without any communication between producers and processors. Apple is the only crop processed on a commercial basis. The production of cigarettes was relatively stable during the transition period. Recently the tobacco industry faces both internal and external problems; lack of constant raw material supply as well as loss of two main tobacco markets: Russia and Romania.

The lack of new required skills together with lack of cash for financing working capital to run processing activities make this sector absolutely inactive. Almost all plants work only around two to four month a year, or at the capacity of 30-40% of their capacity. There is no analysis of profitability, planning, cost control, and monitoring of the company budget. The development of the agriculture sector of Moldova is directly connected to the processing industry. The regular supply is the first step to run processing industry according to economic criteria. The number of existing processing plants currently operating in Moldova is much in excess to the current agricultural production.

The lent pace of ongoing reforms is very expensive for the state budget. The state of budget doesn't allow, as before, the subsidizing and disbursement of technical credits and credits granted by state. The canceling of the debts of economic agents, in order to liquidate the damages caused by the natural disasters is inefficient, even have negative results. In the situation of crises created state granted credits in the amount of 360 million lei. But only 50% were reimbursed which bring the losses in the amount of 141 million lei. The historical debts of the agricultural enterprises constitute on average 2 billion lei, 40% of which represents debts to the state budget and social fund, and the rest – debts to other economic agents.

The privatization process is not finished yet, and questions arise about the measures, which can stop the continuous demolition of the private and public property. The property of the agricultural enterprises is in danger of continuous demolition. On average 961 agricultural enterprises could be included in the process of privatization and restructuring. As of January 1st, their assets valued approximately 1.9 billion lei. On average 30% of these enterprises have not complete the re-evaluation of their assets, and 16% of them overestimated their value. Based on the estimation of the specialists of the Center for Private Business and Reforms (CPBR), after completing the restructuring and privatization of the enterprises from the national program, the total amount of repaid debts will account for 200-300 million lei. The remains 430-460 million lei will be canceled during the period of 1998-1999.

The unique possibility of debt cancellation will exist only after the real privatization and restructuring of the agricultural enterprises. The debts canceling should be done only after the completing by the enterprises of reform process. Only a real privatization, accompanied by real reorganization, could insure the growth of revenues to state budget and eventually improvement of the of the whole system functioning.

Since independence the volume of agricultural exports in nominal value registered a continuous growth, being accompanied by an increase of import of food and livestock products. The export expansion is mainly due to increase of prices, rather than to increase in volume of products exported.



Food and agricultural products traditionally dominated Moldovan exports.

Agricultural exports, share in total exports (%)

	1993	1994	1995	1996	1997
Agricultural export (total)	41.3	67.4	72.6	74.3	76.6
Livestock products	6.5	8.1	9.1	7.5	8.9
Fruits, vegetables, cereals	5.7	17.7	10.2	8.5	9.3
Food products, drinks, tobacco	28.3	40.0	51.3	56.8	56.9
Skins	0.8	1.6	2.0	1.5	1.5

The CIS countries and especially Russia are still the main trade partners of the country. The share of exports to Central Europe decreases but the share of EU countries practically remains the same.

Moldova is beginning to face competition from Western European countries, especially Poland, Hungary and Bulgaria, which already started to penetrate the Russian market very successfully. Moldova is not ready to face the new challenges, neither technically nor with respect to human resources. The future success of Moldova's export industry in agricultural and food products in either the CIS markets, or the EU and other international markets, will depend on the competitive supply of higher

Production Cost (PC) and Producer Price (PP).

			1994	1995	1996
Sunflower	PC		236	369	483
	PP		425	578	557
Sugar beet	PC		52	80	97
	PP		37	99	107
Grapes	PC		349	373	461
	PP		384	374	504
Cereals	PC		94	156	342
	PP		242	309	447
Beef	PC		4154	7681	10954
	PP		1345	1345	2171
Pork	PC		4058	5901	7820
	PP		2332	2332	4308
Lamb	PC		2712	4862	8456
	PP		1029	1029	1761
Poultry	PC		4690	5537	5871
	PP		3607	3866	4799
Milk	PC		431	792	1106
	PP		312	478	673
Eggs (1 thou)	PC		195	247	268
	PP		181	217	260

quality products, and consistent supply, two areas in which Moldova, with few exemptions, is not competitive.

Since independence Moldova signed a free trade agreement with 10 countries, an agreement for partnership and collaboration with EU, and currently is negotiating the WTO membership. The development of external relations representing an important aspect for agrarian reforms.

In January 1992 in Moldova were officially liberalized prices on the most of the consumer goods. It is difficult to choose the prices so it could attend both the market stabilization and assure a corresponding level of producer's income. In general the "shock model" of price liberalization has brought a huge amount of external debts and instability in local market.

During the transition an increase in production costs over the producer price can be easily noticed especially what concern livestock products. The production costs of meat products are 2-4 times higher than their producer prices, which eventually makes highly unprofitable their production and completely explains its continuous decrease. For milk, eggs, poultry, fruits and berries the production costs are slightly higher than the producer prices, but the gap seems to decrease over years.

Price stabilization, based on the international average prices over the last years, could represent the opportunity cost for the long period of exports. But the general tendency of the agricultural products prices on the world market is in decline. If the average world price is taken as a reference, the following is necessary to consider: the support of process of agriculture modernization in order to avoid the high production cost; establishment of loyal market conditions; to practice a comparable agriculture with those of developed countries in order to achieve a comparative advantage.

Land reform

One of the most controversial issues that the first task of agricultural reform, which is the elimination of the state monopoly on ownership of land, still remains unsolved.

The land reform started in January 1991, along with enactment of Land Code, but went very slowly during the transition period. The first effort of land privatization was done in early '90s, when 180 thou ha in 1991 and 300 thou ha in 1992 were given to the population in form of household plots. Then followed period of stagnation almost for four years, due to many drawbacks in the legislation and bureaucratic constraints. Starting with 1996 the process received a new impulse, when Constitutional Court canceled restriction on land buying-selling transactions, and then accelerated significantly in 1997.

More than 1 million of the present and former state and collective farm workers and rural citizens have the right to land ownership with the average size of about 1.7 hectares. At the beginning of 1998, only 21% of agricultural land (540 thousand ha) were by individual sector (340 thousand ha - household plots, and 200 thousand ha - independent peasant farms), the remained 61% were controlled by various large-scale enterprises, which in their essence represent the same state collective structures. Thus, the statement that 82% of Moldovan land is in private property is exaggerated. Issuance of land titles has just created an illusion about the continuation of the reforms in the countryside. The state retains 18% of agricultural land in a reserve fund, which is given in lease to producers.

The “Land” project, which is implemented with the technical assistance of USAID, is the main project dealing with land privatization and agricultural enterprises restructuring. Project started in spring 1996 following an intergovernmental agreement between Moldova and the USA and began its activity with “Maiak” enterprise. The project is operating through the Center for Private Business Reforms (CPBR) in close co-operation with the Ministry of Privatization and Administration of State Property. The commencement of the project follows the main objective of elaboration of the methodology of privatization and restructuring of agricultural enterprises with the final goal being land and property distribution. At the end of pilot stage 72 enterprises were privatized, 100 thousand ha of land and property worth of 200 million lei were distributed.

In order to accelerate the path of reform Government adopted the National “Land” Program for privatization and restructuring of agricultural enterprises. The program is implemented by CPBR, together with Booz Allen and Hamilton and East-West Institute of Management, companies that provide technical and consultative support.

Presently 793 enterprises presented their requests of joining the National Program, and 652 of them already concluded contracts of participation. But land and property distribution has been temporally suspended due to huge debts of agricultural enterprises. As long as the law on enterprises restructuring is active, the property distribution can not take place. The laws on bankruptcy and enterprises restructuring are not efficient under the created situation. Implementation of bankruptcy procedures will take months or even years, but the existing laws concerning enterprise debts are encouraging them to continue debt accumulation. Since the procedures stipulated by the law does not allow the acceleration of agrarian reform it is absolutely necessary to adopt a new law, which would have greater impact. Only after completing the reforms, the enterprises’ debts will be automatically canceled. As the new law would have temporally character, the enterprises will be stimulated to start and finish the reforms process within the time stipulated in the National Program. But the most important factor is that the new law would stimulate creation of new enterprises based on private property and insure the liquidation of those having huge debts.

The land will be privatized very soon and then distributed to the farmers. This is indeed a very important development in the history of the country, which would have consequences not only for the people directly involved but also for the country as a whole. In the end a new group of people would emerge in the economy. These people with the time will become more and more responsible for ensuring the development of the agricultural sector for the economic health and future benefit of the country’s economy. Thus is both for the farmers interests and for the best interests of the nation, that the private farmers sector is fully supported and encouraged. Agrarian reforms are not completed just at the stage of land distribution but are continuing with property consolidation, modernization of economic and production structures. What will happen to the new landowners and how will they organize their work within the created infrastructure? Farmers face the situation when they need to be competent and skilled. They are now responsible for making their own policy about what it is necessary to produce, how it will be accomplished, where and how to sell the final product. This is a new experience of the newly emerged farmers, and not every farmer is able to perform these roles equally well. The division of land into small private farms, which are then subdivided into smaller plots based on different crops has several advantages – more employment, more fair distribution of income, and wider home market for the manufacturing sector. However small holdings must also be capable to face other

requirements as well. It is essential to consider the effects of land reform on agricultural production, both for export and for increasing food production. At present day, the farmers can not get help they need. Neither local authorities or the Government agencies are able to give the support they need, due to their own scarcity of resources and the problem involved in physically dealing with so many thousands of small farm units, comparing to the small number of former collective units. Experts from various fields who worked in the former system need to be retrained in order to deal with the entirely changed environment which private farmers face, since now their experience can hardly be applied to the new circumstances.

As a solution to the created problem, TACIS project Assistance to Reform the Agriculture Support System elaborated the draft of the law on cooperation in agriculture, which would be hopefully approved by the Parliament till the end of the current year. Present law puts a stress on constituting and functioning of agricultural service co-operatives such as: processing, collecting, transporting and storing, sorting and trading the agricultural production, etc.

The idea of the creation of service co-ops is based on the experience of co-ops development in some of European countries (Ireland, Denmark, Holland, France, Germany, etc). Of course all these countries adopted their own model taking into account specific circumstances of each country. The co-operation at the village level would be one solution to use the existing infrastructure in order to increase farmers' efficiency. Nevertheless, decisions about the organization of the new farmers activity depends entirely on the own will.

Seven years passed, and the agrarian policy was based on the assumption that agricultural growth is ensured by rapid technical changes: allocating few resources for the rural development, heavily taxing if possible, and getting the agricultural outputs cheaply to support industrial development. Now, hopefully, the policy-makers understand that agriculture cannot be neglected since it is adequately providing employment opportunities, materials, markets and savings to the industry.

The fact that agro-industrial sector faces certain problems does not in itself justify the government intervention; it only identifies the potential area for it. An analysis of the appropriate policy for Moldovan agriculture must therefore begin by identifying factors which led to the current crises and the instruments the Government could use to remedy the situation.

4.4 Domestic trade and services

Domestic trade.

The economic decline, along with the decrease of the purchasing power of population, and the slide of domestic trade into the unorganized market essentially caused a fall in domestic trade. In 1998 the gross domestic sales in real terms amounted to about 1.96 billion lei, a 61% drop. Public catering has a stable share of 8% in gross domestic sales.

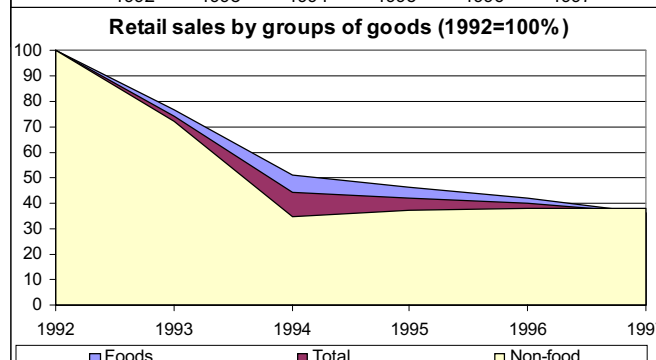
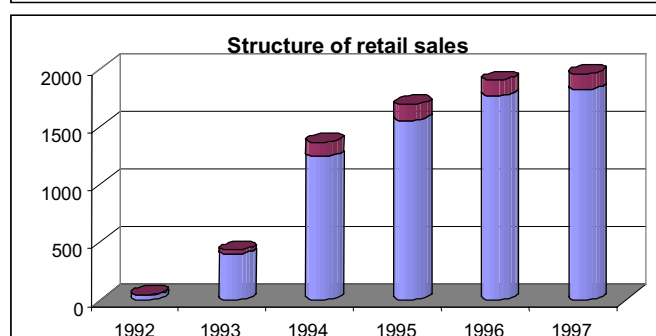
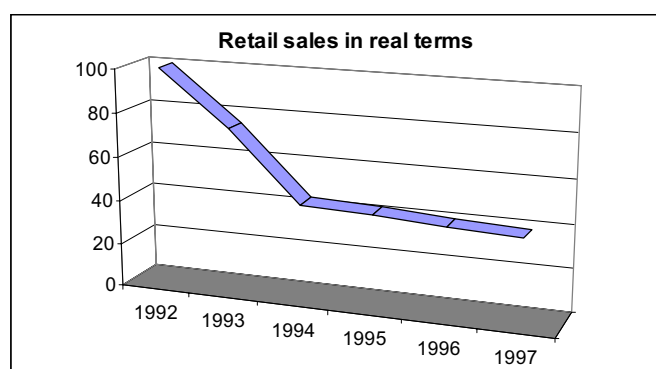
The share of foodstuffs in retail sale is constantly growing (from 51% in 1992 to 65% in 1997). The decline in real sales of food merchandises was larger than of non-food goods. During this time prices of foods increased 116 times, and only 98 times of non-food items.

The analysis of *per capita* sales suggests that sales on the organized market amount to only 5-10% of the total. It is hard to conceive that average *per capita yearly* sales come to only 2.5 kilograms of meat, 600 grams of fish, 200 grams of butter, and so on. The share of organized trade (in fact, the part taxed by the state) is permanently diminishing, destroying any hope of getting more budget revenues from this sector, which is the most profitable at the moment.

Rural population, which constitutes 54% of the total, held 32% of the total trade in 1992 and only 26% in 1997. This confirms the fact that rural population is getting poor faster.

The structure of retail trade is shifting towards private sector (from 39% in 1992 to 70% in 1997). Simultaneously, the mixed sector is growing (18%).

The number of public retail trade units decreased from 3300 in 1992 to 504 in 1997, while of private ones - increased from 1800 in 1992 to 6488 in 1997. It is important to notice that the average yearly volume sold by one enterprise in the public

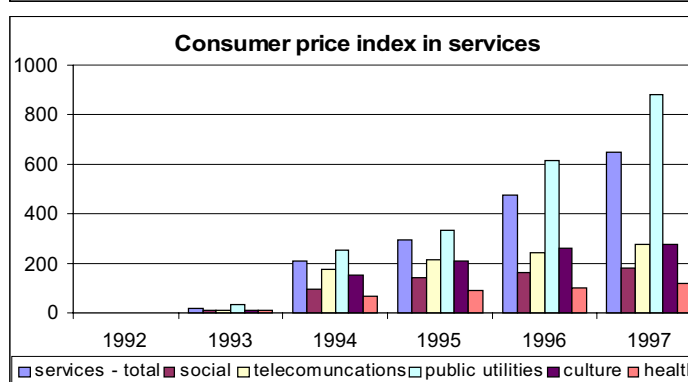
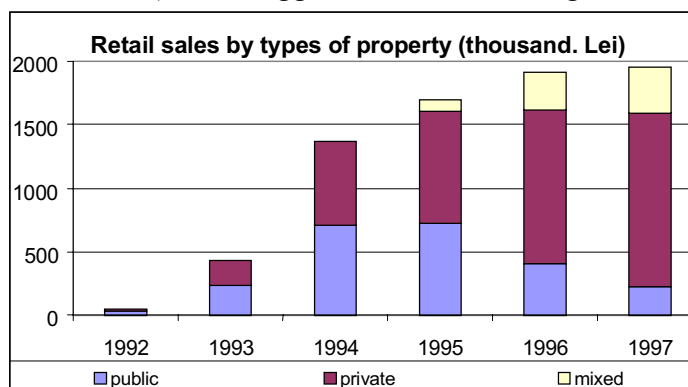


	Unit	1995	1996	1997
Meat	kg	1.68	2.89	2.53
Fish	kg	0.46	0.82	0.62
Butter	kg	0.32	0.34	0.20
Vegetal oil	kg	0.63	0.91	0.79
Eggs	piece	10.12	43.78	40.49
Sugar	kg	1.89	3.65	5.89
Potatoes	kg	2.16	2.81	1.97
Vegetables	kg	3.36	3.33	3.47
Fruits	kg	1.85	5.61	7.62
Vodka	liters	1.68	1.24	1.37
Brandy	liters	0.11	0.17	0.18
Champagne	liters	0.24	0.04	0.04

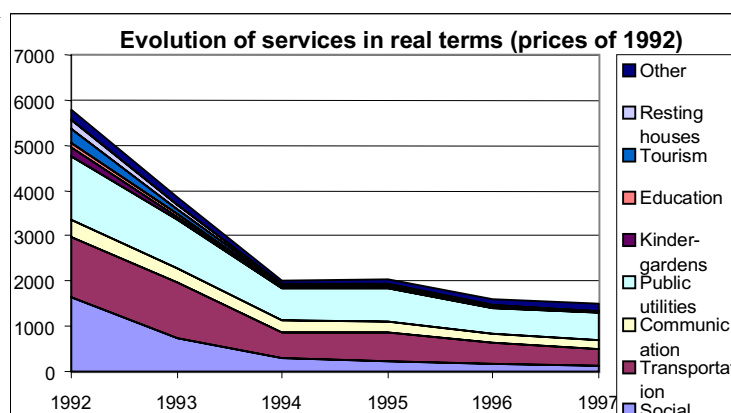
sector did not change in real terms (8.7 thousand lei in 1992 prices), while in the private sector it decreased from 10.3 thousand lei in 1992 to 4.2 thousand lei in 1997 (only 350 lei per month – which is incredible). This suggests about concealing of real data on commercial turnover in the private sector.

A positive tendency of diminishing retail stocks (from 90 days sales coverage in 1992 to 54 days in 1997) is marked. On October 1, 1998 the retail merchandise inventories were estimated at 246 million lei, and marked a two-percent reduction compared to the same period of 1997. It ensures a 51 day reserve. Domestic trade become more flexible, and responsive to demand.

According to the data presented by the Department of Statistical and Sociological Analysis, commodities with a net worth of 2,791 million lei were sold during first three quarters of 1998 (8% decline in real terms compared to the same period of 1997). This can be explained by the deterioration of purchasing power of the population, salary arrears for budget sphere employees, enormous pension debts, continuous economic decline and emerging of inflationary tendencies. The private sector accounted for 74% of the total sales, the public sector – 7%, and the mixed sector -19%.

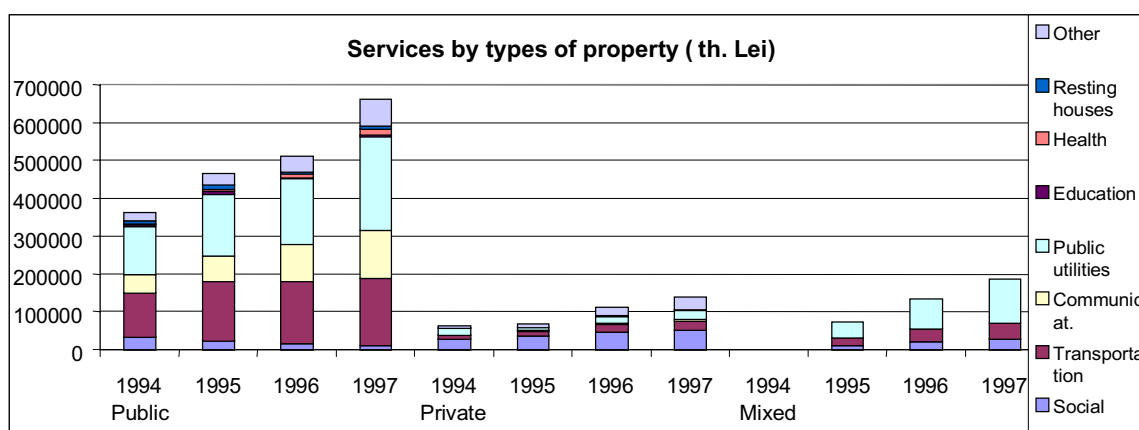


Services. The volume of services rendered for fees to the population increased in nominal terms from 5.79 million lei in 1992 to 987.5 million lei in 1997. The decline in real terms in the amount of rendered services is deeper than in retail, constituting 74% for the given period. The structure of services has also modified. Consequently, the share of social services in the total decreased from 28% in 1992 to 9.5% in 1997, of utilities - increased from 24% to 39%, and of communications - rose from 6 to 13 percent. Relatively stable remained the share of transportation (23-24%).



The inflation and gradual convergence of domestic and international prices changed in a different manner the prices of goods and services. Thus, the largest increase was experienced in utilities – 884 times, transportation – 492 times, culture and communication – 276 times. The price of services soared 651 times overall.

The public sector is dominant, when taking into account the division by type of property (362.6 million lei in 1992 and 662 million lei in 1997). This is mainly due to utilities, transportation, and communications. Its share in total services constituted 85.6% in 1994 and 76% in 1997. The share of private sector remained virtually unchanged at 14% (61 million lei in 1994 and 138 million lei in 1997). However, the mixed sector emerged, accounting for 19% or 186 million lei in 1997.



During first three-quarter of 1998 services were rendered, valued at 976 million lei through all the channels. This was 3% lower than in the same period of 1997 in comparative prices. The share of public services sector amounted to 67% of the total services, of the private sector to 14% and of the mixed – to 19%.

It is necessary to solve the problems related to the implementation of a modern market-oriented system of trade and services, rational positioning in the territories of retail-sale and service enterprises, renovation of accountability of sectors' enterprises to statistical offices, ensuring functioning of legislation related to consumer protection. The Government should find a way to attract the retail sale and the services system into the formal sector of the economy, so it would become liable to taxation.

4.5 Foreign Trade

Globalization of the world economy, opening of a number of economies to international flows of goods, services, capital, labor force, and information creates, on one hand, absolutely new economic opportunities, practically not achievable in previous years, on the other hand, rises the dependence and the vulnerability to external shocks. The external trade of the Republic of Moldova suffered a number of modifications since obtaining the independence. Unfortunately, some of these changes cannot be regarded as positive. The degree of openness of the economy of Moldova, being calculated as the rate of external trade to GDP, grew up. By 1997 this indicator reached 113.5%. The trade balance worsened both in nominal and in real terms, reaching its minimal value of 344 million lei in 1997.

By the moment of obtaining the independence, the Government stood for a structure of exports being less colonial, more industrialized, with a larger share of

finished for consumption goods. The reality displays an increase of agro-industrial complex's exports in total exports from 40% in 1992 to 70% in 1997. This increases the economic dependence of the economy on climacteric factors. A positive tendency of diminishing share of energy resources (from more than 40% in 1992 to 33% in 1997) and textiles (from 10.5 to 5.7%) emerged. A large share of imported foods is of a certain concern, especially since it was believed that Moldova has a comparative advantage in this field.

Geographic structure of imports shifted: the share of imports from CIS fell from 75.6% in 1992 to 51.6% in 1997, while from the rest of the world - increased. This is reasonable, since Moldova is opening to new partners.

Increasing share of imports from Russia is alarming for the economic security (from 38% in 1992 to almost 60% in 1997). The financial crisis in Russia (August, 1998) generated a shock in demand for Moldovan exports. This led to a dramatic fall in Moldovan exports and the cession of production of some Moldovan enterprises. Thus, in September-October, 1998 the export of fruits and vegetables to Russia and Belarus was almost suspended. According to the Ministry of Agriculture and Processing Industry, export of 90-100 thousand tones of fresh vegetables, 110 thousand tones of fruits, and 10 thousand tones of grapes is expected in 1998. As of the end of October only 10 thousand tones of vegetables (10% of the planned quantity), 12.3 thousand tons fruit (11%), and 2 thousand tones grapes (20%) were actually exported.

The analysis of Moldova's foreign trade in real terms is of interest. The evaluation of a sample of exports and imports of Moldova in prices of 1994 (thousand US dollars), represented by a set of 56 goods (43-60% of total imports), and of 47 goods (64-68% of total exports), showed that imports have risen by 45%, while the exports remained unchanged during 1994-1997.

It is good to notice that the prices of exports grew by 64%, while of imports - by only 26%, according to our estimations for the given period of time. However, this is not resulting from some policy of increasing efficiency of Moldovan exports, but from the fact that, at the beginning Moldovan exports were sold at considerable lower prices than the world prices. The spontaneous entering into the market economy forces Moldova to accommodate to international demand, prices and standards.

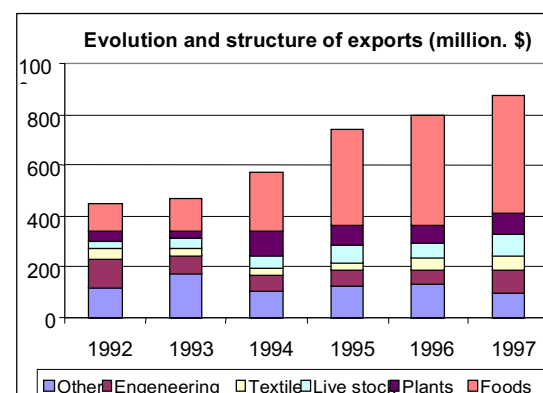
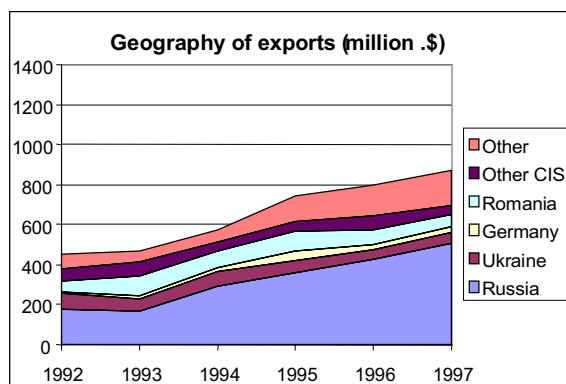
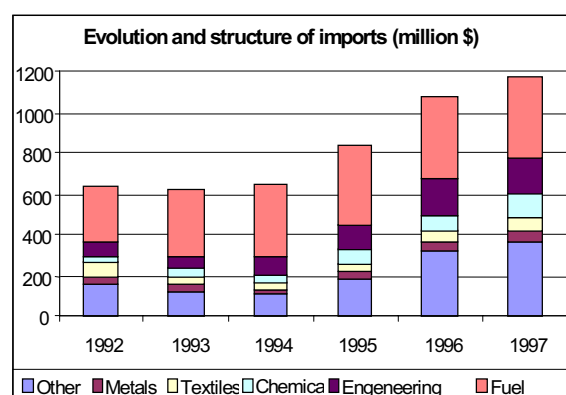
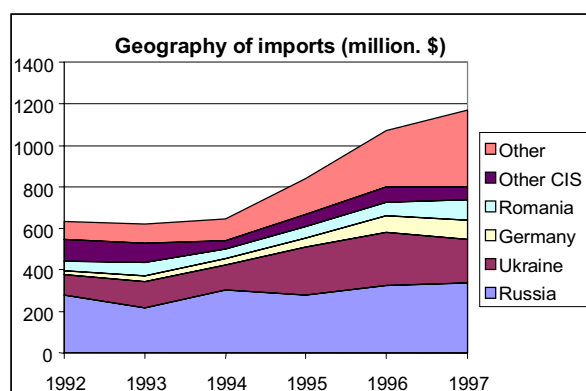
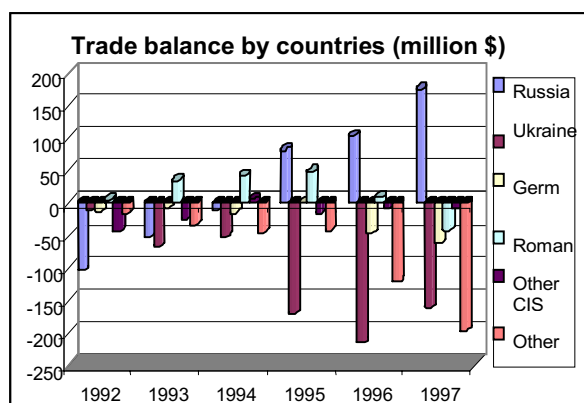
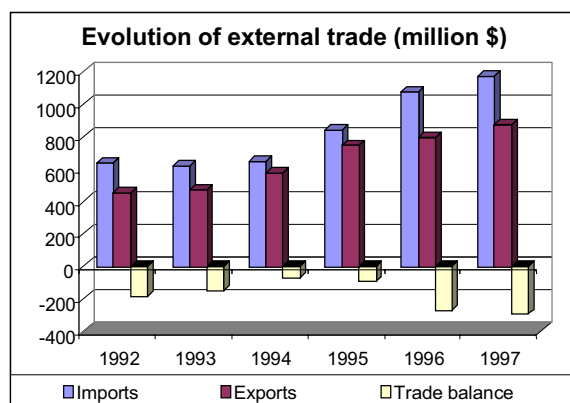
The survival of Moldovan economy requires an urgent elaboration and implementation of economic and organizational measures for expanding the market, exporting Moldovan goods to nontraditional directions (Afro-Asian countries, for example, where the temps of population growth is much higher than the growth of their agro-alimentary sector) Moldova also requires assistance from international economic institutions to fight the results of the current crisis, negotiation of some facilities for the Moldovan exports to the EU (even temporary ones).

Exchange rate and country's foreign trade. It is well known that the result of foreign activity of a country depends on its currency exchange rate, i.e. net exports depend on the real exchange rate.

The simplest definition of the real exchange rate (ϵ) is equal to the nominal exchange rate e multiplied by the ratio of the domestic price level P_d to the foreign price level P_f .

$$\epsilon = e * P_d / P_f \quad (*)$$

The export is more convenient when real exchange rate is smaller, i.e. the net exports are a function of the real exchange rate. Therefore, it is normal to expect an export boost as a result of the Moldovan leu depreciation. But the efficiency of such measures for the Republic of Moldova should be prudently estimated.



Data from the National Bank of Moldova show that since its introduction leu depreciated by approximately 230-250% in nominal terms. But in real terms leu essentially appreciated (see chapter 2), negatively impacting net exports.

There are several causes for this contradictory phenomenon of evolution of the national currency rate in real and nominal terms. One of them is the internal and external price equalization tendency as a result of price liberalization and Moldova's direct participation on the international markets. Thus, the table below shows a relatively faster increase in the prices of exports.

Another cause is the local psychology of adaptation of prices to the changes in nominal exchange rate of the currency. High inflationary environment in Moldova in early 1993 resulted in a subconscious adaptation of the population to convert everything into US dollars, even when the actual transactions were expressed in national currency. The population got used to consider the average salary to be USD 50, GDP - close to two billion dollars, a loaf of bread about 20 cents, a kW/h – a nickel, a pair of shoes - USD 25, of boots – USD 50, and so on.

Almost 80 % of merchandises are sold on the non-organized market, which is extremely receptive to changes in the nominal exchange rate. It is enough for the nominal exchange rate to change, and it immediately implies changes in prices on the domestic market. This phenomenon became quite evident in November 1998, when the prices are being changed daily in accordance with the exchange rate. Relatively less elastic are prices for food, energy and services. In formula (*) the depreciation of the nominal exchange rate e implies a more rapid rise in domestic prices P_d than the diminution of e . Hence, the real exchange rate increases.

$$e \downarrow \Rightarrow P_d \uparrow \uparrow \Rightarrow \varepsilon \uparrow.$$

There are several more causes of the real appreciation of the exchange rate. It may be caused for instance by state's economic policy. Macro-texts contain a number of examples, when the state, by stimulating the economy through tax cuts or increased government spending, generates a decrease in domestic savings, resulting in an increase of the exchange rate. The investment promotion and domestic markets protection policies, domestic savings reduction (the case of Moldova) have a similar effect on the real exchange rate.

An explanation of evolution of the trade balance and its components is required in these conditions. The correlation method indicated the following relationship function between net exports and real exchange rate for Moldova

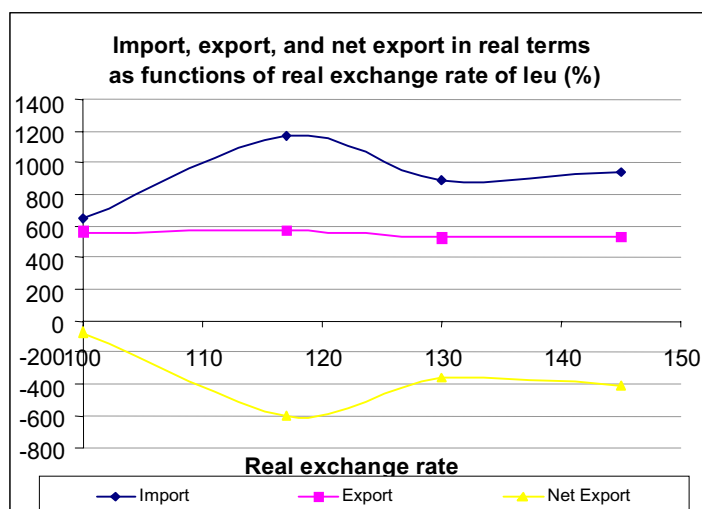
$$NX(\varepsilon) = - 5.62 \varepsilon + 505.06 \quad (R^2 = 0.84)$$

This basically shows that the increase in the real exchange rate by one percent resulted in a USD 5.26 million reduction of net exports in 1994 prices (USD 7.8 million in 1997 prices), while the real exchange rate of the Moldovan leu grew by 45%.

Net exports may be divided into its components – imports and exports in order to study their elasticity to changes in the exchange rate. The same method gave the following relationship between the real exchange rate, exports (EX) and imports (IMP):

$$EX(\varepsilon) = 6.67 \varepsilon - 75.62 \quad (R^2 = 0.94)$$

$$\text{IMP}(\varepsilon) = 12.29 \varepsilon - 580.68 \quad (R^2 = 0.97)$$



The basic result is: an appreciation of the real exchange rate by one percent generates a double increase in imports, compared to exports (both calculated in nominal terms). Furthermore, imports have a big constant component of energy resources. Similar calculations for real exchange rate show an insignificant decline in exports (USD 0.91 million) and an increase in imports (USD 4.8 million). However, the results are quite unstable, since R-squared are inadmissible low. Both cases, for nominal and real terms calculations, display a greater elasticity to the exchange rate fluctuations of imports compared to exports.

Question: after a seven times increase by the NBM of the money supply (M0) in the last four and a half years, would it be efficient to depreciate the exchange rate in order to support the foreign trade?

Answer:

1. The devaluation of the Moldovan leu takes place in the conditions of inflationary expectations. Therefore, domestic prices are rising, resulting in a real rate appreciation. Thus, domestic goods are not becoming cheaper, and this cannot stimulate exports;
2. Even performing a real exchange rate devaluation, the NBM would most likely discourage imports instead of encouraging exports, and this would be a positive result;
3. Such a policy however, would generate an increase in prices for energy resources relative to domestic goods, having an unfavorable impact on the entire economy;
4. Export-promotion policy based on national currency depreciation is a short-run solution, and it can not be implemented in the long run;
5. A rapid growth of inflation would reduce Moldova's economy rating, which would become less stable, and less attractive for foreign investors.

4. Real sector: official and underground economy

Evolution of nominal and real imports of the Republic of Moldova (1994-1997) base year - 1994																
	Unit of measure	1994			1995				1996				1997			
		Quantity	Thou \$	price	Quantity	Thou \$	Thou \$(1994)	price	Quantity	Thou \$	Thou \$(1994)	price	Quantity	Thou \$	Thou \$(1994)	price
1 Poultry	Thou pieces	752	279	0.37	1485	764	551	0.51	974	557	361	0.57	1148	725	426	0.63
2 Beef	Tons	46	38	0.83	672	987	554	1.47	542	602	447	1.11	1213	1445	1001	1.19
3 Fish	Tons	1495	810	0.54	4886	3362	2647	0.69	11353	9120	6150	0.80	9811	7067	5315	0.72
4 Potatoes	Tons	13876	1769	0.13	18120	3264	2310	0.18	62915	11845	8019	0.19	26167	4154	3335	0.16
5 Banana	Tons	796	268	0.34	3307	713	1116	0.22	3157	765	1065	0.24	3931	968	1326	0.25
6 Citrus	Tons	1992	654	0.33	3965	882	1302	0.22	3372	849	1107	0.25	6046	1486	1986	0.25
7 Tea	Tons	338	527	1.56	114	216	178	1.89	147	335	229	2.29	145	396	226	2.73
8 Wheat	Tons	38574	6166	0.16	62753	5008	10030	0.08	34867	7188	5573	0.21	8957	1623	1432	0.18
9 Rye	Tons	16470	987	0.06	63559	4389	3807	0.07	7949	349	476	0.04	202	25	12	0.12
10 Barley	Tons	21742	814	0.04	10837	496	406	0.05	1054	142	39	0.13	15164	2341	567	0.15
11 Corn	Tons	39266	9524	0.24	39224	6345	9514	0.16	63	138	15	2.18	1326	439	322	0.33
12 Rice	Tons	3016	535	0.18	4048	1764	718	0.44	7895	3652	1401	0.46	18642	7416	3308	0.40
13 Malt	Tons	350	74	0.21	4310	859	912	0.20	3693	1556	782	0.42	5215	2253	1104	0.43
14 Margarine	Tons	98	48	0.49	659	683	320	1.04	729	815	354	1.12	1209	1287	587	1.06
15 Sugar	Tons	4085	1168	0.29	9184	3510	2626	0.38	59000	23224	16872	0.39	21000	7373	6005	0.35
16 Cocoa	Tons	536	831	1.55	607	990	941	1.63	519	882	804	1.70	640	1304	993	2.04
17 Fruit juice	Tons	1139	478	0.42	1138	702	478	0.62	1768	884	742	0.50	3379	2959	1419	0.88
18 Natural wine	Thou deciliters	83	479	5.79	614	4191	3559	6.82	1351	7458	7827	5.52	1457	7211	8441	4.95
19 Sparklin wine	Thou deciliters	90	834	9.29	385	3411	3575	8.86	443	3291	4117	7.43	234	1884	2178	8.04
20 Alcohol ethilic	Thou deciliters	714	4167	5.84	828	5149	4830	6.22	1500	12266	8758	8.17	1655	12750	9661	7.70
21 Brandy ans liquors	Thou deciliters	32	746	23.54	114	3148	2688	27.57	43	2278	1015	52.86	17	1214	405	70.58
22 Cogniac	Thou deciliters	2	170	100.01	0	39	40	97.75	10	418	1040	40.17	16	1110	1580	70.27
23 Tobacco (raw)	Tons	1921	2240	1.17	1307	1241	1524	0.95	2342	3991	2731	1.70	876	1899	1021	1.94
24 Salt	Tons	31382	978	0.03	39502	964	1231	0.02	46849	1267	1460	0.03	52166	1650	1625	0.03
25 Cements hydraulic	Tons	57308	1237	0.02	46164	996	996	0.02	12740	573	275	0.04	9993	575	216	0.06
26 Asbestos	Tons	52	3	0.06	2804	539	160	0.19	1537	364	88	0.24	3190	695	182	0.22
27 Coal	Thou Tons	2445	54185	22.16	1315	48905	29135	37.20	1079	47483	23906	44.02	372	17577	8250	47.21
28 Cocs si semicocs	Tons	3453	255	0.07	14139	1368	1045	0.10	12653	1645	935	0.13	8839	1010	653	0.11
29 Aviation gasoline	Tons	7976	1452	0.18	10403	2040	1894	0.20	6890	1565	1254	0.23	34	15	6	0.43
30 Gasoline	Thou Tons	200	34380	172.25	250	52170	43027	208.85	220	48599	37894	220.91	271	64185	46644	237.02
31 Diesel	Tons	264	36010	136.61	375	69523	51269	185.25	354	72602	48318	205.27	338	75636	46187	223.71
32 Fuel, mazut	Thou Tons	492	40850	82.96	482	41095	39979	85.28	310	33907	25701	109.45	271	29907	22449	110.52
33 Natural gas	Thou m3	1897	147153	77.58	1762	102187	136687	58.00	2038	118209	158124	58.00	2076	120764	161087	58.16
34 Electric power	Thou kW/h	615	9447	15.35	1997	47577	30651	23.83	1806	39624	24646	24.68	1978	61915	30364	31.30
35 Mineral fertilizier	Tons	2139	366	0.17	2144	901	367	0.42	2149	585	368	0.27	14317	6065	2451	0.42
36 Synthetical cautchouc	Thou pieces	703	473	0.67	615	945	414	1.54	319	644	215	2.02	279	559	188	2.01
37 Tyres	Thou pieces	38	2115	55.23	4383	19771	242070	4.51	101	12037	5601	118.71	148	13526	8186	91.27
38 Beef skin	Thou pieces	2025	1624	0.80	991	1232	795	1.24	418	608	335	1.46	210	252	169	1.20
39 Beef leather	Thou m2	113	389	3.45	84	1400	290	16.66	127	1638	436	12.95	102	1773	351	17.42
40 Timber	Thou m2	285	613	2.15	108	443	232	4.11	132	729	285	5.51	93	303	200	3.26

**Evolution of nominal and real imports of the Republic of Moldova
(1994-1997) base year - 1994 (continuation)**

	Unity of measure	1994			1995				1996				1997			
		Quantity	Thou \$	price	Quantity	Thou \$	Thou \$(1994)	price	Quantity	Thou \$	Thou \$(1994)	price	Quantity	Thou \$	Thou \$(1994)	price
41 Wood particul board	Thou m3	17	1149	68.40	21	1635	1457	76.78	27	2246	1833	83.80	18	2235	1211	126.26
42 Wool	Tons	1438	2191	1.52	772	1866	1177	2.42	915	2201	1394	2.41	897	2072	1367	2.31
43 Raw cotton	Tons	368	340	0.92	656	1091	605	1.66	165	299	152	1.81	0	0	0	0.00
44 Cotton fabric	Thou m2	6088	3278	0.54	4475	3083	2409	0.69	5344	4774	2877	0.89	3669	2779	1975	0.76
45 Flax	Tons	1005	1196	1.19	570	1004	679	1.76	653	1214	777	1.86	279	528	332	1.89
46 Flax fabric	Thou m2	300	849	2.83	755	1180	2141	1.56	234	423	664	1.80	265	365	752	1.37
47 Linoleum	Thou m2	160	388	2.43	60	300	146	5.00	43	179	104	4.18	61	227	149	3.72
48 Other footwear	Thou.pairs	235	1032	4.39	137	630	603	4.59	271	1229	1190	4.54	359	1049	1577	2.92
49 Footwear from genuin leather	Thou.pairs	304	1568	5.16	106	861	547	8.12	148	1101	765	7.42	361	1560	1861	4.32
50 Waste cast iron	Tons	409	10	0.02	1324	249	32	0.19	584	313	14	0.54	188	111	5	0.59
51 Waste copper	Tons	767	591	0.77	2843	2922	2192	1.03	1317	1381	1015	1.05	1298	1381	1001	1.06
52 Refrigerators	Pieces	3883	806	0.21	8427	2897	1750	0.34	11600	4343	2409	0.37	15400	5444	3198	0.35
53 Electric accumulators	Thou pieces	49186	2159	0.04	35301	2359	1549	0.07	26657	1838	1170	0.07	34066	1806	1495	0.05
54 TV sets	Pieces	5679	950	0.17	1727	392	289	0.23	2965	659	496	0.22	22825	5140	3818	0.23
55 Tractor	Pieces	318	830	2.61	115	522	300	4.54	229	2944	598	12.86	528	5754	1379	10.90
56 Cars	Pieces	1060	5375	5.07	1817	7964	9214	4.38	1606	8615	8144	5.36	1013	7936	5137	7.83
Total in the selection	Thou \$		387849.7			473124.1	659957.44			508443.8	423368.715			503920.1	407115.303	
IMPORT -TOTAL (nominal)	Thou \$		640998.5			840713.4				1072258				1171718		
Share of the selection in total imports	%		60.50711			56.2765				47.41807				43.00694		
IMPORT in real terms			640998.5			1172705				892842.6				946626.9		
Deflator of imports	1		1			0.716901				1.200948				1.237782		

4. Real sector: official and underground economy

**Evolution of nominal and real exports of the Republic of Moldova
(1994-1997) base year - 1994**

	Unit of measure	1994			1995				1996				1997			
		Quantity	Thou \$	price	Quantity	Thou \$	Thou \$(1994)	price	Quantity	Thou \$	Thou \$(1994)	price	Quantity	Thou \$	Thou \$(1994)	price
1 Beef meat	Tons	23235	23627	1.02	29578	34967	30076	1.18	13609	18803	13838	1.38	18029	27040	18332	1.50
2 Pork meat	Tons	5682	7738	1.36	4948	7461	6739	1.51	10005	19394	13626	1.94	15786	32352	21499	2.05
3 Lamb	Tons	239	205	0.86	511	631	438	1.23	898	1060	769	1.18	1506	1999	1290	1.33
4 Comestible organs	Tons	802	305	0.38	1492	526	567	0.35	424	216	161	0.51	384	321	146	0.84
5 Poultry	Tons	19	20	1.08	573	1113	618	1.94	2185	4567	2358	2.09	3311	5295	3574	1.60
6 Milk, sour cream	Tons	2274	462	0.20	2687	539	546	0.20	4550	6990	925	1.54	2452	3687	499	1.50
7 Butter and dairy products	Tons	3496	6697	1.92	1739	5186	3332	2.98	1372	3844	2628	2.80	58	194	111	3.33
8 Eggs	Milion pcs	2	101	45.89	6	388	271	65.81	21	1241	945	60.22	15	1185	670	81.19
9 Honey	Tons	198	259	1.31	123	263	161	2.15	232	388	304	1.67	378	627	496	1.66
10 Tomatoes	Tons	12849	2623	0.20	6989	8598	1427	1.23	6346	1972	1296	0.31	2026	730	414	0.36
11 Cucumbers	Tons	2457	555	0.23	911	491	206	0.54	411	208	93	0.50	718	305	162	0.42
12 Grapes	Tons	137014	24539	0.18	13703	3606	2454	0.26	12790	3169	2291	0.25	2451	735	439	0.30
13 Apples, quince	Thou Tons	100	24241	243.38	68	19176	16550	282.00	37	13915	9054	374.05	62	18295	15163	293.65
14 Wheat	Tons	665	39	0.06	110529	12706	6473	0.11	56646	7725	3317	0.14	10946	1148	641	0.10
15 Corn	Thou Tons	39	30357	772.45	28	12323	21320	446.49	39	10714	30048	275.43	60	19866	46038	333.32
16 Wheat flour	Tons	78	16	0.20	12698	3686	2590	0.29	11594	3786	2364	0.33	1958	712	399	0.36
17 Sun-flower seeds	Tons	20600	4199	0.20	24988	6506	5093	0.26	40961	9400	8348	0.23	68169	13624	13894	0.20
18 Vegetable oil	Tons	16031	8463	0.53	13606	10537	7183	0.77	3764	3001	1987	0.80	11470	7944	6055	0.69
19 Sausages	Tons	1108	1936	1.75	1830	4301	3197	2.35	1657	4469	2895	2.70	3045	8094	5320	2.66
20 Sugar	Thou Tons	101	31173	310.18	135	58907	41812	436.99	108	51273	33499	474.75	159	61180	49287	385.02
21 Molasses	Thou Tons	37	2471	66.96	44	3820	2960	86.42	43	4290	2852	100.71	16	1574	1085	97.14
22 Jams	Tons	5628	2912	0.52	7476	4917	3968	0.66	5855	6066	3030	1.04	6837	9332	3538	1.36
23 Fruit juices	Thou Tons	53	21265	399.72	61	48179	24423	788.52	54	42843	21465	797.82	67	47603	26661	713.69
24 Natural wine	Thou deciliters	11585	45380	3.92	15096	73978	59135	4.90	13628	99860	53385	7.33	18078	185761	70815	10.28
25 Sparkling wines	Thou deciliters	2113	13123	6.21	1459	17303	9063	11.86	2393	31568	14860	13.19	1720	28113	10681	16.35

**Evolution of nominal and real exports of the Republic of Moldova
(1994-1997) base year - 1994 (continuation)**

	Unit of measure	1994			1995				1996				1997			
		Quantity	Th. \$	price	Quantity	Th. \$	Th. \$(1994)	price	Quantity	Th. \$	Th. \$(1994)	price	Quantity	Th. \$	Th. \$(1994)	price
26 Wine raw materials	Thou deciliters	1654	3613	2.12	9346	20861	19854	2.23	12560	45892	26679	3.66	9407	41207	19902	4.36
27 Vermut	Thou deciliters	82	503	6.12	74	954	451	12.92	189	1580	1158	8.34	176.3	1774	1078	10.06
28 Ethilic alcohol	Thou deciliters	416	3066	7.38	202	1565	1488	7.76	603	5388	4447	8.94	195.5	1792	1442	9.16
29 Brandy, liquors	Thou deciliters	612	16399	26.80	1080	29929	28930	27.72	795	24061	21308	30.26	57.6	2419	1544	41.99
30 Cogniac	Thou deciliters	239	16914	70.98	325	29953	23046	92.25	189	14869	13401	76.76	129.6	15065	9199	116.24
31 Tobacco (raw)	Tones	17370	13902	0.80	17804	15542	14249	0.87	11236	13902	8995	1.24	7318.2	12226	5857	1.67
32 Grawl, sand	Th. Tones	230	330	1.44	237	967	341	4.08	130	1039	187	7.97	51	515	73	10.11
33 Beef skin	Tones	4893	4424	0.90	5788	6638	5233	1.18	2638	4086	2566	1.44	3150.4	4497	2848	1.43
34 Lamb skin	Th. Tones	367	810	1.71	615	1688	1050	2.74	570	2272	974	3.98	302.5	1349	516	4.46
35 Beef leather	Th. m2	243	1347	5.54	313	3347	1735	10.70	240	2941	1330	12.26	317.9	3687	1763	11.28
36 Wool (raw)	Tones	329	168	0.51	2629	1611	1348	0.58	2044	1505	1045	0.74	1678	1516	963	0.81
37 Cotton fabric	Th. m2	2134	1181	0.55	274	385	151	1.41	630	536	454	0.66	1206.7	365	668	0.30
38 Carpets	Th. m2	1211	11995	9.90	724	9147	7166	12.64	641	10241	6349	16.97	634.1	11409	6279	17.89
39 Other footwear	Th. pairs	260	695	2.68	221	1053	591	4.77	380	1650	1016	4.35	210.5	1401	563	6.65
40 Footwear from genuin leather	Th. pairs	203	792	3.91	95	744	372	7.81	105	1210	415	11.38	200.6	3450	784	17.20
41 Footwear from textiles	Th. pairs	748	813	1.09	543	675	590	1.61	295	615	279	2.40	67.2	214	73	3.19
42 Refrigerators	Pieces	47000	5441	0.12	20600	2738	2385	0.13	653	155	75	0.24	140	49	16	0.35
43 Washing machines	Th. pieces	72	6203	86.63	33	2959	2833	90.47	31	3854	2703	123.54	27.2	3544	2395	130.30
44 Electric accumulators	Pieces	4156	563	0.14	6700	367	908	0.05	23707	725	3214	0.03	45116	1743	6116	0.04
45 TV sets	Th. pieces	94	13400	143.16	29	4191	4080	147.06	16	2747	2248	174.99	6.3	1254	502	199.08
46 Tractors	Pieces	1463	7034	4.81	1035	6630	4876	6.41	535	6151	2572	11.50	481	6628	2313	13.78
47 Cars	Pieces	76	322	4.23	191	1055	808	5.53	42	263	178	6.26	49	383	207	7.82
Total in the selection	Thou \$		362323			483704.2	373085.79			496446.8	327937.439			594087.2	362752.702	
EXPORT -TOTAL	Thou \$		565501.7			746529.7				795187				874444.6		
Share of the selection in total export	%		64.07107			64.88061				62.43145				67.93095		
EXPORT in real terms	Thou \$		665502			675034.4				625276				533691.4		
Deflator of exports	1		0.999999			1.296496				1.513846				1.637747		
NET EXPORT (prices 1994)	Thou \$		-75486.5			-587671				-367967				-412696		

Conclusion: It is certain that the NBM is able to manipulate the leu exchange rate both towards appreciation and depreciation in order to stabilize the banking system. However, the positive effects of these measures at the macroeconomic level would not be significant.

A range of measures directed towards the improvement of trade balance and foreign trade is required. The following series of action are essential:

- cancellation of fiscal facilities for *imported* goods which are substitute the locally produces ones, even in the free enterprise zones;
- concluding of only of only dollar denominated contracts for all import-export transactions;
- obligatory diversification of energy resources imports by fixing the maximum allowed share of specific countries in total imports and creating a really competitive environment in energy sector;
- an immediate dislocation of the customs along Transnistria border aiming at stopping smuggling, accomplishing the customs reform, and attracting to the decision making positions in customs of foreign specialists paid out of technical assistance, funds;
- Monitoring and informing population regarding bad quality of imported goods, introduction of non-economic barriers for the imported goods of bad quality¹;
- Elimination of all fiscal, procedural (licensing) and organizational barriers for exports;
- Development of marketing studies, especially in placing publicity abroad for local goods as being healthy and natural. A deduction from the taxable amount of the expenditures for publicity;
- Wide informing of population regarding prices on other markets, including the distant ones, as well as prices for transportation services;
- Privatization, restructuring and retechnologization of enterprises for improving their competitiveness;
- Promotion on the foreign markets of such less traditional goods, as walnut, packed honey, peeled sun-flower seeds, healthy confectionery from soy (bean), raisins, dried prunes and apricots, vacuum-processed fruits, mushrooms, mollusks, astrakhan and nutria furs;
- A study of the possibilities to direct Moldovan exports toward the non-traditional markets of the Afro-Asian countries, where the growth of population is expected to exceed the growth in food sector of economy;
- Evaluation of the efficiency of export-import operations, taking into account the comparative and absolute advantages of Moldova in comparison with EU and CIS countries for a number of goods (according to the existing methods), and on the basis of these evaluations – elaboration of a list of strategic goods for export, negotiation of facilities and establishing quotas for exports and imports for countries – members of economic agreements.

¹ The bad quality of imported goods is of certain concern. The frequency of negative results during the quality controls of imported goods was 79% in 1997, and 86% in 1996. The Republic of Moldova, being a small open economy, implements a policy of trade liberalization. Often the imported goods create a serious competition for locally produced goods, frequently easily substituting them, and reducing the local production. Informing the population about the quality of imported goods protect somehow the local producers.

4.6 Private sector

Privatization. Establishment of a viable private sector is a primary condition for the transition to the market economy. At the beginning of '90 it was believed that privatization process would last 3-4 years, and, as a result, a new class of owners would be formed: owners vitally interested in the intensification of the economic activity, in rising its efficiency, capable to make sufficient investments in production, flexible and competitive in the domestic and foreign markets. Since the beginning of the '90s, three privatization programs were adopted and implemented, the first one - for Patrimonial Bonds - in 1994, the second - mixed privatization for Bonds and cash - in 1995-1996, and, finally, privatization for cash exclusively in 1997. At present a possibility of extension of the last program till 1999-2000 is examined.

The stage of privatization for Patrimonial Bonds, as a formal way of avoiding possible social conflicts caused by unfair distribution of public property, should have been accomplished in minimal terms. But the lack of experience in elaboration and adoption of the legislation regarding privatization, the need to compile the lists of potential owners, numerous faults in the evaluation of property's cost, and, lastly, lack of interest in privatization process from a part of population caused an inadmissible delay of privatization for Patrimonial Bonds.

As a result of this, former public property was dispersed among a huge number of Patrimonial Bonds owners, not capable to collect (save) funds for investments in re-technologization of the private enterprises. That practically showed an absence of real owners. A big part of equipment was dismantled, de-completed, stolen, and this diminished the attractiveness of the enterprises subjected to privatization.

The representatives of the state became incapable and not interested to really influence the enterprise's management, share of the state were used without any control, the private sector has been rapidly sliding to the underground zone.

The stages of mixed privatization – for Patrimonial Bonds and for cash, as well as of privatization for cash, evolved quite slow. Causes of delays in privatization, and low participation of the population in privatization lack of property rights protection because of a weak juridical system, huge debts of enterprises, overestimation of privatized enterprises, corruption, mass poverty among population, unfavorable legal framework for the development of private sector.

Taking into consideration the need to increase the budget income, and the fact that the realization of the privatization program was slowed down, in October, 1998, the Government and the Department for Privatization made efforts to accelerate the privatization for cash. Thus, since the beginning of 1998 (January-September), the Department of Privatization held 11 investment and commercial tenders, having put up for sale 85 enterprises. However, only 7 objects were traded, the total worth being 13.5 million lei. Of this sum, 8.4 million lei have already been received by the State Budget. The sales of state property during October amounted to 9.2 million lei and 13.18 million lei were received by the State Budget.

Unfortunately, the procedures of privatization of some enterprises have long lasting histories (Cement factory, MoldTelecom, Tutun company). However, the situation is changing: after the Russian companies the Western ones followed (Lafarge, Voxtel – France, Kulkony – Germany), etc.

Energy sector. The situation in the energy sector threatens the whole economy of the country. On the 13th of October there was proposed to declare an emergency situation in this sector, which could have resulted in suspension of the legislation in this area, and a takeover of the entire financial administration of the sector by a special governmental commission.

By October 1998 Moldova accrued 1.3 billion lei (\$ 260 million) in gas debts, some 471 million lei in electricity and thermal energy debts and 165 million lei in fuel debts. Moldova owes Russia \$175 million in debts and \$75.3 million in fines. Regarded as a whole, the Moldovan energy sector works under extremely unfavorable conditions. For example, the electric sub-sector is constantly close to a bankruptcy state.

The major causes of this situation are: lack of a real owner, consumers' insolvency, extension of barter deals and mutual payments, freezing and rescheduling of debts, energy facilities for the agricultural sector, incorrect tax policy and high commercial and technical losses, thefts of energy.

For a normal development, Moldova must repair the electric equipment, gas and thermal installations, and purchase some 360,000 tons of coal (13.6 million dollars) and 214,000 tons of fuel oil (21.5 million dollars). The total cost of energy supplies for electricity and thermal energy is estimated at 107 million dollars. At the same time additional 900 kW of electricity costing 32 million dollars are required.

By October 8, Moldova acquired only 62,000 tons of coal, 41,000 tons of fuel oil, 5,900 tons of diesel and 10,200 tons of petrol. The reserves of natural gas also constitute 69 percent of requirements.

In order to improve this situation it should be found a real owner with decision-making rights and responsibilities in this sector through its privatization. By now, individual privatization projects have been prepared for energy sector enterprises, namely for 3 electricity-heating generating plants and 5 regional electricity distribution networks.

Gas sector. On October, 26, 1998, Russia, Moldova and Transnistria signed an agreement on setting up an open-type joint-stock company, MoldovaGas. The equity was distributed as follows: 50% will belong to Gazprom of Russia, 36 % to Moldova, and 14 % - to Transnistria. The company has thus become the owner of the entire gas transportation and distribution system of Moldova and Transnistria having a total worth of \$290 million.

At present, the Republic of Moldova owes some \$600 million to Gazprom for the fuel consumed, of which \$400 million is the debt of Transnistrian part. By cession of 50% of the shares to Gazprom, Chişinău is counting to cut its indebtedness to Moscow by \$47.3 million, and Transnistria - by \$12.7 million.

The Moldovan Government has approved the plan of restructuring a part of its debt through passing over to Gazprom a package of state bonds worth \$90 million payable in 7 years at an interest rate of 7.5 % p.a. In 1996, Moldova supplied Moscow with similar securities worth \$140 million.

However, it is not quite clear, how it is possible, that the cession to Russia of 50% of a US\$ 290 million venture reduces Moldova's debt to Russia by only \$47million. Besides, Transnistria, having two thirds of the debt for gas, will receive almost half of Moldovan's share - \$78 million, or 27% of the total.

MoldTelecom. One of the reasons of MoldTelecom's failure to be privatized is the inability to recover its own money. By September, 1989, MoldTelecom's accounts

receivable soared to 47 million lei (9.5 million dollars), of which 31 % is to be repaid by businesses, and the other 31% by individual users. State-run institutions owe 26 percent of the total debts, while the share of collective agricultural enterprises was 12%. Among the largest debtors are the Ministry of Internal Affairs with 1.3 million lei (267,000 dollars) in debts, the Chişinău City Hall - over 1 million lei, the Ministry of National Security and the Ministry of Education - over 700,000 lei each.

On October 10, MoldTelecom has been authorized by the Ministry of Transports and Communications to disconnect the lines in ministries which fail to pay in time for telephone services. On October 15, MoldTelecom has announced new charges for a series of home services, starting 1999.

On October 14, the Government has approved a legislative plan of reorganization and privatization of the state-run MoldTelecom company.

An initial privatization plan approved by Parliament in July 1996 stated that a foreign partner must offer at least \$120 million for a 40% stake in the company, of which \$18 million would pay for a seven-year operating license. The remaining \$102 million was earmarked for capital investment in MoldTelecom. In a tender set up by Western consultants with the backing of the European Bank for Reconstruction and Development, two companies decided to participate in the sale – a French-Danish consortium incorporating France Telecom and GN Store Nord, and Greece's state telecom company OTE Telecom. But OTE Telecom offered only \$46.4 million for the stake, and this offer was rejected by the Government, while the French-Danish consortium withdrew from the tender for unspecified reasons.

The new plan of MoldTelecom privatization includes three stages. In the first stage, the enterprise is supposed to be converted into a joint-stock entity. In the second, the Government will hold an international tender to select a strategic investor who will receive 51% shares. Three percent of shares will be sold to MoldTelecom employees. In the third stage heavy investment in the enterprise modernization is foreseen.

The plan targets to raise the number of telephone lines in Moldova from the current 14 to 24 per 100 people in the next five years. According to the plan, the investor would have an exclusive license for international and local telephone communications for five years, as well as a priority right to buy the next license for mobile telephones in Moldova. During the first two years after the sale the current tariff structure would remain unchanged, the plan says, with further consideration of the official rate of inflation. The plan, announced at the government meeting, still has to be approved by the Parliament.

Cement factory. Previously, the Rezina factory was put up for sale three times, but unsuccessfully. The Moldovan cabinet was blamed for charging a too high price. The enterprise also tried to obtain fiscal facilities in order to avoid bankruptcy, but it was unable to improve the situation with its own forces.

The Government announced that Lafarge (Finarge-26) has won the tender for foreign investors who intended to buy the control stock in the Rezina factory, and thus obtained the State owned package of shares of 52%.

To rehabilitate the cement production at the big cement mills, it is necessary to invest in modern packaging lines, to introduce energy-saving measures, and modernize the main kiln. The minimal investment program will require no less than \$5 million. The factory's projected capacity is over one million tons of cement a year. State received \$ 200 thousand

for its 52% share. The factory's payables are approximately 30 million lei. At present, annual cement consumption in Moldova is about 500 thousand tons.

The package is worth \$200,000. Besides, Lafarge shall pay all huge enterprise's debts (about \$ 6.1 million), and invest \$12.7 million in production development. At present, Lafarge and the Government are negotiating to sign the contract.

Carpet maker "Floare". On the 20th of October the German company Kulkony has put off an agreement to buy the 58% state share in the Moldova-largest carpet maker Floare-Carpet for the first decade of November.

Previously, the agreement was scheduled to be signed on October 10-15. Kulkony reportedly intended to offer 1 million lei for the state's share in Floare-Carpet and further invest in the enterprise 80,000-90,000 Deutsche marks. The conditions also read that the German side would pay off all the debts of the Moldovan company, which are estimated at 3 million lei (over \$526,000).

Moldovan wineries located in Russia. The Department of Privatization and State Property Administration of the Ministry of Economy and Reform has put up for a commercial tender the State-owned parcels in 3 Moldovan wineries located on the Russian territory - in Oryol, Votkinsk, and Tver cities. The Votkinsk Winery's statutory fund equals to RUR (Russian rubles) 9.1 million, with 49% shares belonging to the Moldovan Government. The object's starting price is 1.5 million lei. The Oriol Winery's statutory fund equals to RUR 80 million, with 49% shares belonging to the Moldovan Government. The object's starting price is 1.5 million lei. The Tver Winery's statutory fund equals to RUR 41.6 million, with 49% shares belonging to the Moldovan Government. The object's starting price is 3.8 million lei. All these three wineries specialize in processing wine materials delivered from Moldova and other grape growing regions and in bottling wines and vodkas.

It is strange, that in the conditions of a high inflation in Russia (expected to reach more than 250% by the end of 1998), the statutory capital of Moldovan wineries is estimated in Russian rubles. Thus, the sale of Moldovan wineries to Russia is going to be more likely a donation.

Tobacco sector. Preparatory work is under way now to privatize the tobacco sector enterprises, including the biggest of them, "Tutun" joint-stock company. Assistance in finding strategic investors and in preparing the units for privatization is rendered by Raiffeisen Investment A.G. of Austria. According to Mr. Pierre Heidebroek, Raiffeisen Project manager, the company will render assistance in organizing 20 transactions (international tenders), in the restructuring and attraction of foreign investors for companies under the Conversia Holding.

The first stage of tobacco sector restructuring will include privatization of tobacco fermentation factories. It is expected they will become private already by the end of this year or in January 1999. Upon completion of this work, the Department will proceed to the privatization of "Tutun".

As a first step, the Department intends to announce a tender next spring for selecting a foreign consultant for preparing "Tutun" for privatization.

Other enterprises. The Moldovan Department of Privatization and State Property Administration has also put up for sale State-owned blocks of shares in the following enterprises:

Moldcarton – the main producer of packages made of flat and corrugated cardboard. Its statutory fund accounts for 119 million lei, the state holding 89% of shares.

Faprochim - the country's biggest producer of paints, detergents and domestic chemical items. Statutory Fund - 9.1 million lei. The State holds 61.7% shares.

Codru - the country's leading manufacturer of furniture. Statutory fund - 21.7 million lei. The State holds 65.5% shares.

Zorile - the country's biggest footwear and leather item producer. Statutory fund - 21.7 million lei. The State holds 60 % shares.

The Balti biochemical plant, with a statutory fund of 3.6 million lei. The State holds 74.7 % shares.

The Ozyorny mine/quarry enterprise - a known producer of construction raw materials. Statutory fund - 4.7 million lei. The State holds 62 % shares.

Moldagrotehnica - manufacturer of equipment and machinery for agrarian product processing. Statutory capital - 1.5 million lei. The State holds 96 % shares.

Protos - a pipe manufacturer. Statutory fund - 8.9 million lei. The State holds 98% shares.

Avicola-Drochia - duck breeder and duck egg and meat producer. Statutory fund - 1.9 million lei. The State holds 89% shares.

Functioning of private sector

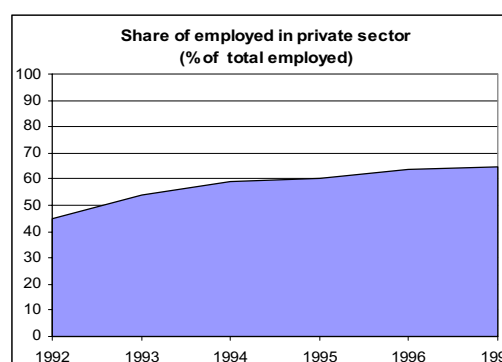
The analysis of data regarding the contribution of private sector to the total economy displays different tendencies depending on the branch. Thus, during 1994 – 1997 the share of private sector in the output of industry has diminished. This can be explained by many reasons. Hence, one of the reasons is that the Department of Statistics estimates data regarding

the development of industry based on a selection of enterprises. As the time passes, the structure by forms of property of this selection changes, and this could introduce distortions in indicators. Another reason is unfavorable conditions for private sector development within the formal economy. The share of private sector in agriculture is growing continuously (from 42% in 1994 to 52% in 1997). Private sector has developed most quickly in the retail sale (48–70%), and this is normal, taking into consideration the fact that this economic sector needs a relatively small initial capital, it is more profitable, and recovers rapidly. Rendering of services by private sector

Share of private sector in economy		1994	1995	1996	1997
Industry	total	3747	4265	4690	5889
	private	1723	1972	1868	2246
	private (%)	46	46	40	38
Agriculture	total	4106	4218	4463	4480
	private	1725	1839	2276	2330
	private (%)	42	44	51	52
Retail sale	total	1363	1692	1904	1956
	private	651	880	1209	1374
	private (%)	48	52	64	70
Rendering of services	total	424	606	757	988
	private	61	87	110	139
	private (%)	14	14	15	14
Capital investments	total	712	845	987	1202
	private	328	461	494	525
	private (%)	46	55	50	44
Fixed assets put into operation	total	405	624	858	1093
	private	207	384	457	532
	private (%)	51	62	53	49
Number of employees	total	1688	1673	1660	1646
	private	995	997	1047	1064
	private (%)	59	60	64	65

remained at a relatively constant level - 14% of the total volume. The share of private sector in investments, as well as the process of putting into operation of fixed assets, were growing till 1995, and afterwards started to diminish. The number of employees in private sector accounted for about 60% of the total in 1997.

During first nine months of 1998 the share of private sector in GDP forms 40%. Statistical data regarding private sector development are confusing. The scarcity of information regarding the development of private sector makes practically impossible a comprehensive analysis here. Thus, official statistic says that the productivity of labor in private sector is 3.5- 4.7 times smaller than in the public sector (incredibly), although it grows faster. An analysis of the efficiency of private sector in agriculture and services, using statistical information is impossible to be made. Seeing the widespread individual constructions, it is difficult to believe the statistical data, which shows that the living space put in commission in private sector diminished 2.67 times in 1990-1997, those in rural area – 3.8 times.



Productivity of labor in industry by types of property

		Public sector	Private sector	Private-collective sector
Output in industry (million lei)	1995 current prices	1610.8	22.3	1938.6
	1996 current prices	1537.1	8.4	1844.4
	1996 comparable prices	1192.1	6.5	1430.4
Number of employees (1000 persons)	1995	37.2	2.4	85.8
	1996	25.8	0.5	65.9
Productivity of labor (thou. lei per pers.)	1995 current prices	43.3	9.3	22.6
	1996 current prices	59.6	16.8	28.0
	1996 comparable prices	46.2	13.0	21.7
Rate of growth of productivity of labor (%)		6.7	40.2	-3.9

Actions aimed at private sector development include:

- Approval of the Program for Entrepreneurship and Small Business Support;
- Selling the supplementary spaces rented to the small scale enterprises (500 more enterprises), as well as of the adjacent lands (about 470 parcels);
- Improvement of the terms of payment for privatized premises – 25 % to be paid immediately upon signing of the contract and 75% over three years;
- Taking effective measures towards making the privatized enterprises pay the land rent to local administrations instead of paying land taxes, as it is now;
- Converting the old deposits with state Savings Bank into shares remained after privatization; launching privatization through a repayment of state's debts with assets or shares of the privatized;
- Launch of privatization of energy and telecommunications sectors involving foreign investment in these sectors; privatization of tobacco factories, wineries located in the Russian Federation, as well as of electronics manufacturing industry;
- Acceleration of privatization of agricultural enterprises, promotion of farmers'

associations and allotment of land plots according to the National Program “Pământ”;

- Speeding up of housing privatization and promotion of private housing owners’ associations;
- Supporting greater involvement of Moldovan citizenry in the domestic stock market through measures such as Public Offers;
- Establishment of an integrated system of registration of various types of property;
- Effecting inventories of unfinished enterprises subject to privatization for their further sale for a symbolic price;
- Compilation of a unified information database of public property to ensure its privatization in conformity with the state program;
- Allocation of at least half of the revenues from privatization of public property to restructuring and further modernization of privatized enterprises;
- Improving administration of state-owned property, including those with 100% state capital and those of mixed ownership managed by private partners; establishment of a State Property Fund endowed with legal authority.

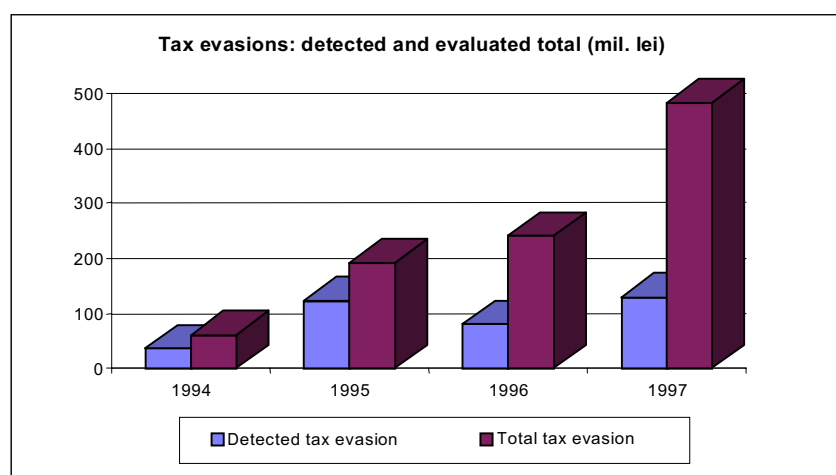
4.7 Economic collapse or the informalization of the economy?

The economic evolution of the Republic of Moldova, similar to other countries in transition, may be characterized by a deep decline. Even if 1997 marked a small growth in GDP, formed about 37% of the level of 1990. The accuracy of this almost three-fold decline, accompanied by an extension of constructions, of the private fleet, of durable goods sails, rises doubts. Undeclared incomes, tax evasion and shadow economy are discussed more and more.

The shadow (underground, informal, second, unofficial, invisible) economy “smoothes” the impact of economic shocks in the transition countries. We can not characterize it unambiguously as being negative or positive. As a complex phenomenon shadow economy includes negative, parasitic, counter-productive aspects, which need to be eradicated, as well as positive, productive aspects. Thus, shadow economy causes losses for the state budget due to tax evasion, it is one of the reasons of the decline of economic discipline and hence of the people’s decreased respect towards state institutions. Being out of the state control, the shadow economy can be one of the potential sources of economic shocks, economic and political instability, in many cases it is closely related to the organized crime. At the same time, the shadow economy brings additional revenues for its operators and members of their families, being sometimes their only source of income, and diminishing the unemployment rate. Shadow economy increases the competitiveness of production, often being cheaper, it can be more elastic, more adjustable to the new conditions, bypassing the bureaucratic obstacles faced by the formal economy, it can serve as a factor of market stability and balance, often offering exactly those goods and services which are in demand in the formal economy. In a way, shadow economy can be a factor of financial stability due to the transactions performed in national currency, covering the monetary excess with goods and services.

In this chapter we will discuss the shadow transactions only in a couple of sectors of the economy, negative aspects of the studied phenomenon will be examined.

Tax evasion is a kind of the underground activity, which actually as a more notable impact on the stability in the economy. The society is tensioned, in a big part, by the failure in the payment of pensions and wages for the budget workers, growth of the state budget deficit and debt. On the other side, the supply of free of charge public services to the whole population, including those not paying taxes, worsens the situation in the budget. Our calculations show that during 1994-1997 the volume of tax evasion grew up very quickly – from 65 million lei till about 500 million lei (from 4% of the consolidated budget income till more than 20%). We should mention that this is a minimal estimation, because there is a assumption of the a perfect honesty of tax inspectors in the base of the estimation.



The reasons for the extension of tax evasions include the weakness and corruption of fiscal control institutions, an overdriven system of tax facilities, a heavy tax burden.

The indicator of tax burden being calculated as the ratio of tax incomes (including payments into the social fund) to GDP varies during 1994 –1997 between 30 – 33%. This indicator, in principle, doesn't exceed too much the average per OECD - 28.5%. This figure has emerged as a result, that a part of economic agents do not pay any tax and the other – carries a much bigger burden.

Tax burden (excluding excise)

	1996	1997
VAT (mil. lei)	613.9	800
Profit tax (mil. lei)	358.6	380
Individual income tax (mil. lei)	219.1	230
Payrole tax (mil.lei)	765	920
Sum (mil.lei)	1956.6	2330
GDP (mil.lei)	7317	8280
Share of taxes in GDP(%)	26.74047	28.1401

An evaluation of the tax burden in the real sector of economy for 1992-1997 was done on the base of information derived from the form N2 "Financial results' statement" of all enterprises which submitted this form to the Department for the Statistics.

Average tax evasion per taxpayer

	1994	1995	1996	1997
Total legal entities and individuals	1.58	4.92	3.41	7.68
Recorded individuals	3.09	9.50	7.37	12.01
state enterprises	11.53	48.98	11.30	22.00
collective enterprises	6.07	7.68	53.07	33.38
rented enterprises	5.57	9.12	0.94	5.23
all kinds of cooperatives	3.08	9.06	14.74	19.13
including colchozes	7.18	23.90	43.18	54.10
L.T.D.	0.41	1.00	3.25	9.60
joint stock companies	7.82	10.39	18.09	12.39
enterprises with foreign investments	1.82	1.40	18.07	62.08
social organizations	0.78	0.16	0.85	1.78
insurance companies	0.08	2.41	47.62	7.13
associations, concerns	1.97	1.78	19.19	1.85
farmers	0.00	0.01	0.06	0.02
budget institutions	0.05	0.08	0.43	0.44
other legal entities	0.18	-0.85	5.93	17.00
Individuals - total	0.02	0.06	0.18	0.91
individual enterprises	0.02	0.06	0.21	1.19
collectiv societies	0.12	0.02	1.64	2.00
socien.with unlim.responsib.	-0.10	0.00	1.63	0.35
other	0.03	0.08	0.00	0.10

The calculations showed that the tax burden reached much bigger values (the total in 1997 – 45%, in industry – 50%, in agriculture – 40%, constructions – 38%).

The tax burden is, evidently, much heavier in the Republic of Moldova and it suppresses the economic development. This burden “pushes out” a bigger part of economic agents to the shadow sector of the economy, reduces the tax base in the future and aggravates the problem of budget deficit.

Our calculations show, that in average, the rise of the tax burden by one per cent entails a rise of the “tax evasion/consolidated budget income” ratio by 2.5 per cent. However, diminishing of the tax burden will not be followed *sine qua non* by the growth of tax collections.

Evolution of tax burden in real sector of economy

		Total taxes (million lei)	GDP (million lei)	Tax burden (%)
1992 (including cooperatives)	Total	60.8	176.1	34.5
	Industry	28.3	60.6	46.7
	Agriculture	13.7	59.6	23.0
	Constructions	2.8	9.5	29.5
	Trade	1.9	5.8	32.8
	Communications	0.6	1.6	37.5
1993 (including cooperatives)	Total	456.3	1183.6	38.6
	Industry	183.8	452.9	40.6
	Agriculture	99.7	494.0	20.2
	Constructions	23.2	69.6	33.3
	Trade	19.9	53.7	37.1
	Communications	3.7	11.0	33.6
1994 (including cooperatives)	Total	1484.6	3520.9	42.2
	Industry	751.8	1365.8	55.0
	Agriculture	229.0	980.8	23.3
	Constructions	84.5	193.5	43.7
	Trade	80.0	155.8	51.3
	Communications	22.9	56.1	40.8
1995 (excluding cooperatives)	Total	1782.0	3976.6	44.8
	Industry	638.1	1221.4	52.2
	Agriculture	389.1	1233.9	31.5
	Constructions	97.7	221.0	44.2
	Trade	172.9	353.1	49.0
	Communications	107.5	174.7	61.5
1996 (excluding cooperatives)	Total	1924.5	3751.8	51.3
	Industry	742.2	1186.9	62.5
	Agriculture	412.7	725.6	56.9
	Constructions	96.0	288.1	33.3
	Trade	280.6	566.1	49.6
	Communications	108.8	292.4	37.2
1997	Residents	2227.3	4957.2	44.9
	Nonresidents	223.7	329.3	67.9
	Industry	683.3	1369.4	49.9
	Nonresidents	43.9	79.6	55.2
	Energetics	262.7	-235.1	z
	Agriculture	468.3	1188.3	39.4
	Nonresidents	0.9	3.8	23.7
	Constructions	106.3	276.8	38.4
	Nonresidents	1.2	5.8	20.7

The policy of diminishing the tax burden with the aim of stimulating production output is a gradual process and has to comprise a set of measures as follows:

- explanation to the population of the need to adjust budget expenditures along with the temporary reduction of budget incomes;
- preparation of a training program targeted at explaining the impact of tax evasion on the society's welfare, cultivating a negative attitude towards tax evasion;
- psychological preparation of the economic agents through all possible means of information (mass-media), concerning tougher fiscal controls, and explaining the expected positive effects of these measures, including the diminution of tax burden;
- creation of a unique body vested with sufficient power and rights in fighting tax evasion, including the right to apply administrative sanctions, which would promote

an integral and consistent policy of investigating, detecting and penalizing the tax evaders;

- toughening the fiscal controls (rising penalty rates and frequency of controls to the level that makes the tax evasion economically inefficient);
- as the last step – diminishing the tax burden.

Illegal import-export transactions. Basic forms of illegal transactions in Moldova are: smuggling, “pseudo-barter”, “pseudo-export”, “pseudo-transits”, import-export operations with unjustified unproved modification of prices and “sharing” the benefits among the partners, obviously non-equivalent exchange operations, and finally exceeding the export quotas.

According to the Romanian data (“Curierul National”), the volume of sugar exports from Moldova to Romania exceeded in 1997 the produced volume on the territory of Moldova 1.8 times. Generally speaking, a big part of this sugar is made in the Ukraine, but the certificates of origin of production are faked with the intention of taking advantage from the free trade agreement between Romania and Moldova.

Within the investigation a comparative analysis of Moldovan and Russian sources of information regarding export-import operations was accomplished. The data was compared on a selected number of goods accounting for 47 % of Moldova’s imports and 54 % of its exports. The analysis disclosed essential discrepancies. Thus, the discrepancy reached 55% for imports and 93 % for exports. It is evident, that this degree of deviations cannot be explained by Transnistria’s share in Moldova’s international trade. In terms of this selected group of goods, the budget losses accounted for 35 million lei, resulting from nonpayment of VAT; losses caused by nonpayment of excises, only for wines, accounted for 48 million lei. It is important to notice that a series of goods registered in Moldova as exported (cigarettes, champagne) were not registered in Russia, which allowed the exporters to avoid payment of excises.

According to Moldovan sources, the price but of exported “vodka” practically coincides with the price of the imported “vodka”. Russian sources show a tripled price. The import of Moldovan wine in Russia, according to the Russian source of data, is almost twice bigger than that recorded in Moldovan source, the price “increasing” by 30%.

The absence of temporary customs between Transnistria and the other part of Moldova, and existence of two fiscal systems on this territory, generate considerable losses for the Moldovan budget. The absence of VAT levying on the territory of Transnistria implies the fact that many imported goods pass the customs at Transnistria, then transit to the right bank of the river Nistru then being shown as produced on the territory of Moldova. Thus, these goods are avoiding payment of VAT and are engendering an unfair competition to local goods.

Tobacco complex. As an approach of measuring the scale of the black market, can be used the analysis of discrepancy between production and distribution of tobacco products. This method was proposed by the Norwegian Institute of Social Applied Sciences and was used by the Central Statistical Bureau of Latvia. Within our

investigation an attempt has been made to estimate the minimal volume of shaded transactions in the tobacco industry.

According to the official statistics of Moldova, 9.6 billion cigarettes were produced in 1996. From them there were exported \$ 49.7 billion of tobacco products (\$ 20.89 million to NIS, or 2 billion cigarettes, and to other countries - \$ 28.85 million, or 5.8 billion cigarettes). There were registered as imported \$ 0.42 million (0.04 billion cigarettes). Statistical data in a long run show that the consumption of cigarettes in the Republic Moldova reaches 5 billion cigarettes. The balance is the following:

$$9.6 \text{ billion pieces} + 0.04 \text{ billion pieces} < 5 \text{ billion pieces} + 7.8 \text{ billion pieces.}$$
$$9.64 \text{ billion pieces} < 12.8 \text{ billion pieces by } 3.16 \text{ billion pieces.}$$

These more than 3 billion cigarettes may mean either unrecorded import, or undeclared production. In both cases this means that the budget of Moldova incurred about 110 million lei in losses. This is a minimal estimation, because, according to some sources, the import of cigarettes amounts to about 2 billion pieces. In this case the discrepancy could constitute 5 billion of cigarettes, and income, consequently, bigger.

From the other side, according to the official statistics of Moldova, the retail sale of cigarettes in 1996 amounted to 17.3 million lei (about 350 million cigarettes). This means that the recorded sale of cigarettes equals to only 7% of the total amount.

On October 15, 1998 a common agreement for fighting smuggling between the custom service of Moldova and Cernauti region (the Ukraine) was signed. Even if this is a positive moment, still about 30-40% of the state border are not under control. In the Republic of Moldova practically two custom territories exist. An adjusting of the existing institutional system to the current situation in the country is needed. The territory of the right bank of r. Nistru should become a distinct custom territory for the flows of goods (but allowing free movement of population).

A solution of the problem of illicit export-import demands a set of measures adjusted to the real situation:

- immediate dislocation of a temporary customs service between Transnistria and the other part of Moldova;
- customs' reform;
- attracting of foreign specialists, paid out of technical assistance, funds, assigned to decision making positions in customs structure.

Deviation in information regarding Moldo- Russian import and export in 1996													
	Unit	I M P O R T S						E X P O R T					
		Russian source			Moldovan source			Russian source			Moldovan source		
		Quantity	\$ th.	Price \$ th./un.	Quantity	\$ th.	Price \$ th./un.	Quantity	\$ th.	Price \$ th./un.	Quantity	\$ th.	Price \$ th./un.
Vegetable oil	thou tons							2.02	1894.7	936.12	1.20	1051.3	874.63
Sugar	thou tons							66.96	35423.3	529.02	60.70	29760.8	490.29
Canned vegetable	thou tons							38.38	28931.3	753.79	25.09	20261	807.40
Fruit juice	thou tons							9.63	6040.3	627.11	27.00	16213.4	600.50
Jam	thou tons							3.66	4478.5	1223.30	3.16	4173.6	1322.64
Champagne	thou dcliters	2.40	49.9	20.84				1739.25	31888.5	18.33	2342.80	30684.7	13.10
Vermut	thou dcliters	3.37	73	21.68				286.24	4757.6	16.62	153.30	1355.9	8.84
Other wines	thou dcliters	7.26	70.3	9.68	51.60	416	8.06	21774.54	231633.8	10.64	12178.90	92643.4	7.61
Alcohol ethilic	thou dcliters							239.00	2931	12.26	86.70	719.5	8.30
Vodka	thou liters	28.86	90.8	3.15	4.00	49.6	12.40	4133.83	17185.2	4.16	4063.00	14050.9	3.46
Tobaco raw materials	thou tons	0.05	83.2	1733.33	0.03	59.3	1912.90	13.79	19611.5	1422.46	8.46	11084.6	1309.79
Cigarettes	thou \$		191.8						2927			6697.5	
Coal	thou tons	137.38	6231.9	45.36	106.10	6518.6	61.44						
Fuel	thou tons	38.85	2937.2	75.61	119.70	13041	108.95						
Natural gas	million m3	3154.00	182947	58.00	2038.10	118209	58.00						
Footwear	thou payrs	57.39	759.9	13.24	25.80	318.5	12.34	4178.73	28651.9	6.86	304.30	1308	4.30
Total deviation	thou \$		76246			76246			214237.2			214237	
Share of deviations in the sum imp.(exp)	%		40			55			52			93	
Share of goods in total export (imp)	%					46.99						53.49	

Power-energy complex. The lack of a competitive environment and existing system of granting compensations to producers, implies the growth of shadow transactions in this complex, as well as over-pricing. The growth of electricity losses share can be considered as a signal of expansion of embezzlement. Losses of electricity in the Republic of Moldova are comparable and sometimes exceed their production in the territory of the right bank of r. Nistru. The share of losses and embezzlements grew up from 10 % of the total consumption in 1990 to 30 % in 1997, amounting to about 300 thousand lei per day, based on some estimates, or 100 million lei annually. According to international standards, average losses in the power distribution network accounts for 9-12 % of the total consumption. In the Republic of Moldova this share cannot be explained just by the obsolete equipment; it is caused also by spread of embezzlements. These losses can be observed in geographical differentiation. Thus, in the first semester of 1998 the share of losses in the electric power network amounted to 14.6% in Chişinău, 43.8% in the center of Moldova, 41% in the North, 40.7 – North-West and 46.8% in the South of Moldova.

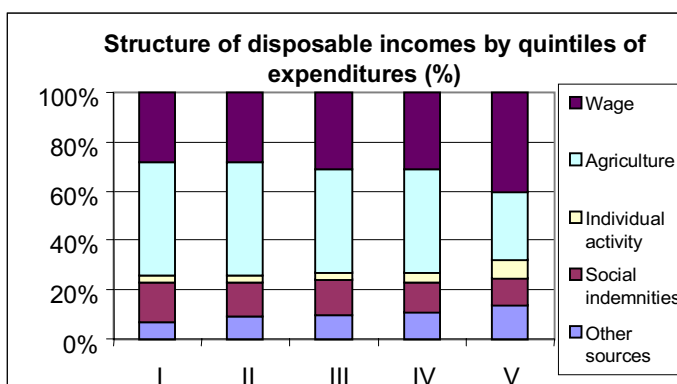
If the growth in prices for energy during the Great Economic Depression implied a restructuring of the economy towards production of less energy-intensive goods, and, as a result, a two-fold decrease of consumption of energy per unit of GDP, then in the Republic of Moldova the consumption of energy per unit of GDP increased during the last three years by 21%. The debts of the energy sector grew quickly.

Solution of the energy complex problems implies such measures as:

- restructuring of the complex, including enhancing debts collection, disconnection of consumers, who are not paying for energy usage;
- privatization of the enterprises of the energy complex;
- elaboration and approval of a set of clear, exact, transparent and predictable rules regarding the operations of the enterprises of the energy complex considered natural monopolist;
- after privatization it is necessary that the state assumes debts of the sector and reschedules them in such a way, so that they do not impact on the future pricing in the complex;
- shifting from the system of subsidizing energy producers to the system of direct subsidizing for the vulnerable parts of population.

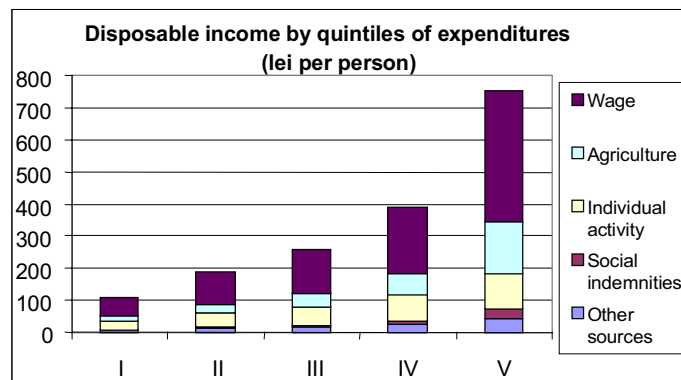
A broad material for the analysis is contained in Households' Budget Survey made by the Department of Statistical and Sociological Analysis under the technical and financial assistance of the World Bank. According to the data of the opinion poll, in 1997 the decile ratio (but, better say, quintile ratio) of

the incomes of 20% of the richest population is more than 7 times bigger than the incomes of the poorest 20% of the population (7.34 – by incomes, and 6.24 by disposable income). The structure of these incomes shows that as the income grows, the share of incomes from agriculture diminishes, and this sounds logical. If we apply absolute values, and take these data in lei per person, the picture changes essentially. Thus, incomes from agriculture in the fifths quintile (the richest one) exceed the same indicator for the first quintile (the poorest



one) by more than 4.4 times. That is to say, in most part, incomes of the richest population come especially from the work in agriculture. This is doubtful.

More suspicious is the situation in the social indemnities. As soon as income grows, the share of social indemnities diminishes, and this makes sense. At the same time, the sum of the social indemnities per person is almost 5 times bigger in families with the maximum level of incomes. The most social benefits enjoys the richest population which is an unfair social system. The situation is especially difficult in the case of failure of the fiscal policy in the Republic of Moldova.



According to the methodology of the Households Budget Survey, the respondents must complete the files regarding incomes and expenditures of the household in order to balance the incomes and expenditures of the household. And the initial discrepancy between incomes and expenditures shall be explained by gifts and loans.

All respondents of the survey were grouped in quintiles (from I till V). There were selected all households which receive incomes from the agricultural sector and they were divided in the public and private sector, and the same was done with the non-agricultural sector.

In the picture we can clearly see the growth of expenditures for every good simultaneously with the increase of incomes. The comparison of expenditures per capita shows that the expenditures for the primary goods (foods, clothes, shoes) are almost the same. Nevertheless, the expenditures for the consumption of meat and vegetables in the private agricultural sector are, on average, 64-65% greater than in the public one.

The expenditures for clothes and shoes in the non-agricultural private sector are on average 38% smaller than in the public sector. The situation changes radically, when on compared the living standards (more specific, the presence of new video- audio consumer goods, refrigerators). Thus, there are on average 19% more color TV, 25% more video-recorders and players, 15% more refrigerators per capita in the private non agricultural sector than in the public one. An exception makes the availability of private cars and minibuses in households due to the widespread practice to register these goods under the possession of retired parents, who belong to inferior quintiles according to their incomes.

Even if it is supposed that the employees of the public sector, unlike those from the private one, do not have any undeclared incomes, these from the private sector, having formally the same incomes, possess approximately 20% more durable goods, or in reality belong to superior quintiles by their incomes. If we suppose that those from the private sector do have undeclared income, the discrepancy will be even larger. Possibly, this is one of the reasons of unfairness in the social sector.

4. Real sector: official and underground economy

Expenditures for basic goods of households from public and private sectors (lei/month)

Bread

	I	II	III	IV	V	Total
Public sector in agriculture	7.05	10.26	18.21	20	27.95	14.74
Private sector in agriculture	11.56	17.06	18.41	23.06	30.97	20.8
Public non-agricultural sector	14.05	17.06	17.85	20	24	21.4
Private non-agricultural sector	11.19	17.31	19.27	20.12	25.62	22.78

Milk

	I	II	III	IV	V	Total
Public sector in agriculture	3.99	13.26	21.12	28.97	32.23	20.77
Private sector in agriculture	4.77	12.77	20.62	22.42	36.49	20.31
Public non-agricultural sector	1.33	5.31	7.17	11.35	17.73	13.34
Private non-agricultural sector	1.92	5.48	6.65	10.32	17.73	13.64

Meat

	I	II	III	IV	V	Total
Public sector in agriculture	5.28	6.97	11.21	17.48	31.97	14.23
Private sector in agriculture	5.6	11.95	16.28	29.42	47.12	23.02
Public non-agricultural sector	1.63	6.29	8.3	15.17	33.06	22.65
Private non-agricultural sector	1	5.97	8.07	16.91	29.68	22.11

Vegetables

	I	II	III	IV	V	Total
Public sector in agriculture	10.29	23.04	34.31	37.04	47.41	31.23
Private sector in agriculture	14.01	20.16	25.57	27.78	34.92	25.12
Public non-agricultural sector	7.87	12.01	15.52	18.29	26.83	21.61
Private non-agricultural sector	5.22	12.19	13.5	16.3	25.73	20.89

Fruits

	I	II	III	IV	V	Total
Public sector in agriculture	1.26	2.03	4.89	7.77	12.68	5.69
Private sector in agriculture	3.44	7.99	10	15.63	11.34	9.43
Public non-agricultural sector	0.93	1.99	2.77	5.97	8.33	6.27
Private non-agricultural sector	0.1	1.17	2.36	3.05	7.14	5.13

Clothes and shoes

	I	II	III	IV	V	Total
Public sector in agriculture	0.04	3.55	6	14.04	47.64	12.34
Private sector in agriculture	0.53	3.46	6.29	11.2	29.43	10.78
Public non-agricultural sector	2.15	3.25	3.54	9.47	40.1	24.47
Private non-agricultural sector	0	2.03	5.44	9.96	53.32	33.84

Durable goods in private and public sectors (pieces per capita)

Cars, vans

	I	II	III	IV	V	Total
Public sector in agriculture	0.1	0.0588	0.1667	0	0.2308	0.1026
Private sector in agriculture	0.012	0.0563	0.0902	0.1382	0.1221	0.0872
Public non-agricultural sector	0.1	0.0845	0.1759	0.1973	0.2928	0.2213
Private non-agricultural sector	0	0.1333	0.0444	0.1333	0.2018	0.1551

New color TV sets

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.0588	0.1667	0.15	0.0769	0.0769
Private sector in agriculture	0.0482	0.0875	0.0574	0.122	0.1679	0.1002
Public non-agricultural sector	0.05	0.1268	0.0741	0.1769	0.2025	0.1601
Private non-agricultural sector	0.0625	0.2222	0.2	0.2111	0.1973	0.1981

New video recorders, players

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.0588	0	0.05	0.0769	0.0385
Private sector in agriculture	0.012	0	0.0328	0.0569	0.0458	0.0291
Public non-agricultural sector	0.025	0.0423	0.093	0.884	0.0685	0.05872
Private non-agricultural sector	0.0625	0.111	0.0222	0.0333	0.0942	0.074

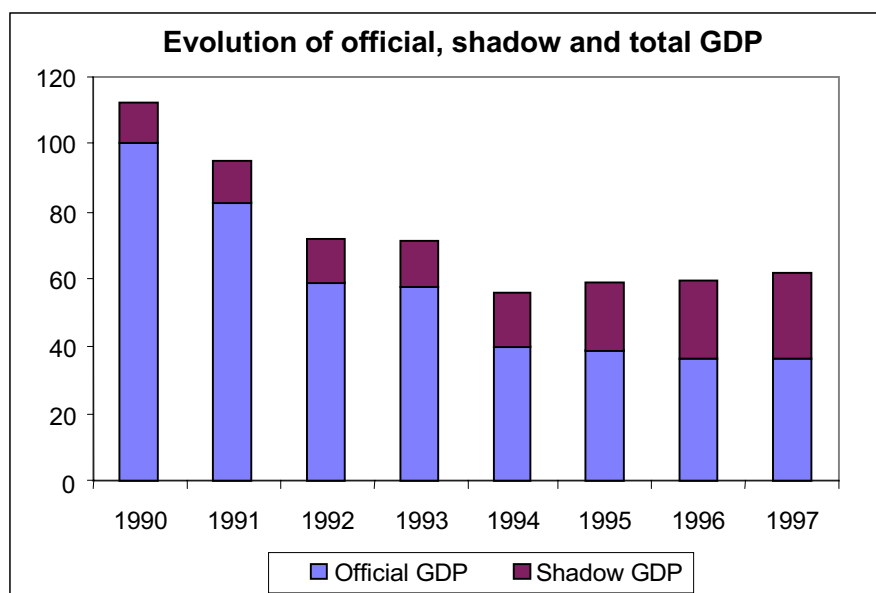
New TV sets

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.2353	0.2222	0.1	0.0769	0.141
Private sector in agriculture	0.1084	0.15	0.1393	0.1626	0.1908	0.1535
Public non-agricultural sector	0.125	0.169	0.1019	0.2041	0.271	0.2111
Private non-agricultural sector	0.0625	0.3333	0.3111	0.2667	0.2242	0.2482

New refrigerators

	I	II	III	IV	V	Total
Public sector in agriculture	0	0.0588	0.1111	0.1	0.1538	0.0897
Private sector in agriculture	0.0241	0.0063	0.0328	0.0325	0.0687	0.0323
Public non-agricultural sector	0.1	0.0282	0.0741	0.0748	0.0779	0.0728
Private non-agricultural sector	0	0.0444	0.0889	0.1	0.0817	0.0788

The evaluation of the proportion of the shadow economy in the Republic of Moldova on the basis of a set of methods, showed that the share of shadow economy compared to that of the formal economy reached up to 60%. Starting with 1994-1995 the national economy, including both, official and shadow parts, started to grow. The real economic decline in the Republic of Moldova is relatively less deep, and it reaches not 63%, as the official statistic says, but a bit more than 40%.



According to the information of the Department of Fighting Economic and Financial Crimes, during the first nine months of 1998 only it registered 2406 economic crimes (174 more than during the same period of last year), the volume of losses is evaluated up to 66 million lei, 27 million lei being reimbursed. There were committed 1321 property violations (4.5% more in comparison with the same period of 1997), 554 financial crimes, 65 cases of tax evasion. The major share of economic crimes took place in the agricultural sector (435 cases) and in the railway system (154 cases).

On October 23, 1998 the Presidents of Moldova, Romania and the Ukraine – Petru Lucinschi, Emil Constantinescu and Leonid Kucima signed a Memorandum for Crime Prevention, which foresees taking common measures for fighting terrorism and international crime, illegal operations with weapons, explosives, toxic and radioactive substances, illegal drug traffic, faking money and certificates, economic crimes. Still, this is not sufficient. The shadow economy is a complex problem, which needs a detailed study by experts in different fields. Elaboration of a methodology of a state strategy regarding the shadow economy, using the international experience in this field, and a real, not declarative, intention to fight the economic crime are needed.

5. Agrarian reform: years of aspiration

The difficult situation of the national economy in the 90's is an non-doubtful argument for pondering on the essential trends of reforms in its key sector – agriculture.

During the recent years after the commence of the launching the last reforms serious changes occurred that deserve to be subjected to a retrospective analysis, that might profile the trend of the phenomena and essential positive processes, for encouraging them, and negative ones, for being hindered.

For all countries, agriculture constitutes the most important factor for equilibrium in harmonizing the economic development. Industrialization was possible only when the agriculture increased its productivity and freed labor force for other activities. The agriculture is the branch of material production that has as objective the provisioning of the population with food products and worthily considered the backbone of a nation.

In Moldova agriculture was and still continues to be the backbone of the national economy. It accounts for more than 40% of the GDP and engages half of the employees.

The importance of the agro-food sector imposes to find and promote a system of productive, efficient and competitive measures.

Vision regarding the agrarian reform. The social-economic changes that intensified in the former USSR and in the Republic of Moldova after 1985, produced great transformations in the national economy, including in the agro-food sector. One of them was transformation of the Republic of Moldova from a “flourishing garden” of the former USSR into an independent state, into an integral economic system which is objectively subjected to reformation. Reform is the notion used to define the change, the political, social, economic transformation, - recently has been used very frequently by all the people.

The evolution of the agriculture from the beginning to nowadays, in the period of formation and consolidation of the statehood of the Republic of Moldova, has been influenced by running those three big agrarian reforms: Cuza's reform from 1964, reform from 1917-1921 and the agrarian reform from 1945-1950.

Moldova, which served for provisioning the necessary agricultural products, obtained by way of purchasing or confiscation, as a result of the Russian-Turkish war from 1806-1812 and 1828-1829 got in a state of economical ruin.

According to the Convention from Paris, the Cogalniceanu Government re-submits to the Parliament the bill “Regarding the regulation of the rural ownership”, promulgated on Aug. 15, 1864 by the ruler Alexandru Ioan Cuza. This one was the most courageous and notorious reform, through which the liberty of the most population was reestablished. The peasants who received ownership started to farm industriously their land plots, whereas the land owners organized more rationally the production on the remained areas.

The agrarian reform from 1917-1921 continued the transformation of the country from state of great landowners into a state based on small peasant ownership.

Distribution of land to all peasants generated distribution of land to many weak economic elements and provoked extension of basically labor intensive crops. The reforms from 1964 and from 1917-1921 ran peacefully, without social tensions.

In the post-war period, after 1944, in the Moldovan agriculture commenced to be run the Soviet model of nationalization and collectivization, through expropriation of farmers and confiscation of land, agricultural equipment, and of everything that was in the ownership of the peasants. The life and labor of the peasants was intensely depersonalized, hence they becoming slaves of the imperial system. By 1950 the state and collective farms all together were operating an overall 1661 thousand ha which constituted about 89% of the sown areas. The private ownership shrunk considerably. This ratio continued until the collapse of the totalitarian regime.

Once with the transformations of the economic relations, was taking place the reform in the agriculture of the Republic of Moldova, launched through adoption by the Parliament, on February 15, 1991, of the concept of the agrarian reform and social-economic development of the state.

The principal orientation of changes in the economic relationships in the rural zone was demonopolization of state ownership and institution of economic mechanisms based on market relationships.

The agrarian reforms were launched as a system, comprising:

- Demonopolization of ownership, including nationalization of the agrarian lands;
- Reorganization of the agricultural exploitations;
- Dismantling the command economy system, considerable reduction of arbitrary intervention of the public bodies in the activity of the agrarian farms;
- Formation of premises for developing the market economy relationships;
- Adequate stuffing of the agro-food sector;
- Creation and maintaining the social equilibrium in the rural localities, providing for social protection of the peasants.

The agrarian reform has been conceived as a fundamental change in this important sector of the national economy. So, which is the pace of reforms, where do the effectuated reforms lead after the launch of the agrarian reforms?

Processes and tendencies in the evolution of the property structure. The property in essence expresses the relationships among people in relation with the goods and comprises the overall economic relations of ownership, possession, usage and disposal.

The opinions regarding the role of ownership in the economic life differs from negation of the impact of the ownership: “property is not any longer the general picture of the social relationships”¹, up to considering the decisive factor of any economic system, up to the conviction, that the private ownership “constitutes, first of all, the premises of manifestation in its own sphere, and secondly, the premises of free coexistence of individuals...”.

Dismantling the state monopolistic centralized system and institution of market economy mechanisms in the agro-food sector is possible only through essential changing of ownership.

¹ Car Grosland. The Future of the socialism. Jonathan Cape 1967, p.66.

Demonopolization of the state property on land, land reform, has been performed in two stages:

On the first stage, which is practically over, each family in the rural zone has been transmitted for free in private ownership at least 0.3 ha. If the family comprises more than three members, it was distributed additionally 0.1 ha per each member of the family, starting with the 4th one, provided the overall area for a family does not exceed 0.75 ha.

Now the area of adjacent lots, transmitted in private ownership to the citizens of the Republic of Moldova constitutes 344.5 ha.

On the second stage of the land reform, launched once with the adoption of the Land Code on January 1, 1992, in private ownership is distributed the equivalent land share from the outside-built over areas.

The process of land shares distribution is running very difficult. On January 1, 1995 the area of land areas distributed into private ownership constituted only 34.5 thousand ha.

The agro-communist Parliament majority, adopting on February 10, 1995 the Law on modification and amending the Land Code, obviously blocked the distribution of land shares in kind. Nevertheless, on January 1, 1996, 58 thousand ha of land were distributed to peasants. This process accelerated after the Resolution of the Constitutional Court of the Republic of Moldova was adopted, dated January 25, 1996, through which were recognized unconstitutional the stipulations of the paragraph 7 of the Article 12 and paragraph 5 of the Article 13 of the modified Land Code. Much contributed to the acceleration of land reform the "Land" Project, generously funded by the US Government.

On July 1, 1998 from outside-built over areas were transmitted into private ownership 298 thousand ha. The private sector constituted about 28% of the farm land. In the USA, for instance, more than 90% of the farm land is private¹.

Considerable efforts have been made to impede, if not even stop, the process of distribution of land shares, either directly, or by devising obstacles.

For the beginning it is worthy to mention, that the Baltic States, as well as those from Eastern Europe, have returned to former land owners, and that's quite natural. In the Republic of Moldova the land is divided to everybody equally: both to industrious and lazy; to those who are good go-and-getters and those who prefer to expect someone else's initiative. Consequently, a good deal of land it is either not farmed or severe technological violations are admitted.

We also note, that the norms included in the Land Code are frequently neglected. For instance, those who are entitled to land share are distributed equal land plots and not the equivalent ones, as stipulated in the legislation, which will engender conflicts in the future.

The same owner is distributed the land share on three or more fields, with the intention to provide for fairness among the peasants of a locality. It is regrettable the fact, that the land shares are distributed like this also in the farms, where the "Land" Project is running. Consequently, the property of a peasant is crumbed too much, which provokes additional unjustified costs.

¹ Land Ownership and Taxation. Westview Press, 1993.

In most cases those few plots are distributed to each member of the family. Thus, the husband holds land plots on 3-4 fields, the wife on other 3-4 fields, a fact which aggravates the situation even worse. It would be proper to distribute the overall equivalent land share for the whole family, on a sole place and on the same field.

The economic freedom of the peasants and stimulation of their entrepreneurial activities can be insured only by creating a material basis. For land-owner peasants, the main source of the material basis formation constitutes the property share deriving from the property of the state and collective farms. The lack of production means, and the dictate of the processing units of agricultural raw materials engenders a total disappointment and generates a hostile attitude towards the agrarian reform. Being aware of this fact, even if there is a good deal of Resolutions of the Parliament, even if there is the Decree of the President of the Republic of Moldova, even if there are a lot of claims from the peasants who obtained the equivalent land shares, the conservatory forces do not wish to deny the property that does not belong to them.

On December 1, 1997, according to the statistical bulletin, only 49% of citizens entitled to property shares of the agricultural enterprises received the property share certificates. About 357 thousand or 66% of the mentioned certificates have been authenticated. The property-owner peasants received about 64% of goods from what they are supposed to receive from the agricultural enterprise property.

At the same time, in 108 enterprises have not been determined the property shares, and, as a result 73 thousand peasants do not know yet the size of their due shares from the goods of the agricultural enterprises, that are diminishing year by year. For example, on January 1, 1991 in the agricultural enterprises there were about 48 thousand tractors, whereas nowadays their number slightly exceeds 45 thousand.

Possessing agricultural much smaller land areas than the public sector, almost without production means, the private sector produces from year to year more and more agricultural output. If in 1985 the households and peasant farms produced 17% of the agricultural output, then in 1990-21%, in 1995-45%, in 1996-50% and in 1997-52%.

This fact convincingly shows the priority of the private ownership and confirms the objectivity of the land reform, as well as the need to urge the privatization process.

The land privatization process is irreversible. It is strategically important to orient and really support the land owners, which will constitute the basic argument in promoting the agrarian reform.

Alterations in organizing the agricultural units. *For the beginning we shall make a statement on the number and structure of the economic agents in the agriculture of the Republic of Moldova.*

Table 1.

Number of the agricultural economic agents

Registered economic agents	1991	1994	1997
Total	1004	4161	42515
Including: state enterprises	400	358	157
Collective farms	534	535	262
Inter-farm enterprises	70	44	25
Joint-Stock Companies	-	36	210
Production cooperatives	-	65	383
Limited companies	-	58	4
Peasant farm associations	-	7	246
Peasant farms	-	3058	41228

The number of the economic agents in agriculture obviously increased. Their number rose due to vertiginous growth of the peasant farms number. It is worth mentioning the emergence of new forms of agricultural undertakings, such as limited companies, peasant farmer associations, and others.

At present one of the most disputable problems is that related to evolution of organizational structures. We shall not try to present an ample analysis of the doctrines. I should remind only, that the confrontations between the adepts of the large plantations prevalence and small ones has its roots centuries ago.

In agriculture the share of small farms from the overall accounts for over 70% in the Far East, over 55% in Africa and Latin America, over 55% in the Middle East. In the agriculture of all developed countries, whose national economy is oriented towards market economy, family farms prevail, constituted basically based on private ownership on land and production means.

The basis of production organization in the Republic of Moldova, both according to the concept of agrarian reform, and according to the realizations during the recent years, is the peasant farm, family farm based on a real economic independence. The family farm, according to many specialists, represents a form of organization which ensures political and social stability, as well as the economic justice for farmers. It is often mentioned that the insufficiency of the peasant farm for implementing the modern technologies. It is true, that the area of the arable land, distributed to one person in the Republic of Moldova, constitutes 0.4 ha. Yet, it is not less true also, that the land area per person in France is – 0.32 ha, in Austria – 0.16 ha, in Italy – 0.16 ha, in Germany – 0.12 ha of arable land, and the family farms are getting on very well. This demonstrates that the argument is not convincing. Even in the statistical bulletin of public information, it is stated, that: “On average a farm possesses about 1.8 ha, of which 1.36 ha – arable land, 0.19ha – orchards, 0.24 ha – vineyards”, which does not comply to reality. These are dimensions of a land share. A family from the rural area comprises 3-4 holders of equivalent land shares, whereas the average dimensions of a peasant farm constitutes 5.4-7.2 ha. Of course, those farms are far less than those from the USA – about 190 ha, are less those from France – 27 ha, Germany – 16 ha, but exceed those from Italy – 5.1 ha and Greece – 4.3 ha. In the whole world, the family farms unavoidably join on the view to use more efficiently the production means, on the purpose to process the agricultural raw materials, transportation issues, sales, rendering consulting services and many other factors. Such associations are done based on private ownership and benevolently. It is imperious today to urge and encourage the formation of an efficient system of services in the agro-food sector. In the strategy of

agriculture formation it is necessary to specify clearly the institute for property on land and forms or agricultural organizations.

The fundamental process of constituting the private property on land causes the need to reorganize the agricultural units. Actually very frequently, the reorganization of agricultural units is carried out only through perfunctory change of name of collective or soviet farm, without changing the content. The share-holders of the joint-stock companies should use the arable lands only based on a lease contract, by preserving the right to ownership on that. The agricultural tools and some other materials and funds comprise the share capital which is totally divided into shares. The associates cannot redeem this capital in kind, can handle only with the shares that express the majority of the share capital. The public authorities insistently propagate the creation of limited companies lead by so-called “leaders”, many of whom being the former chairmen of collective farms, directors or brigade leaders. Unfortunately, this envious strive is promoted by the “Land” Project. The conflicts that are going to emerge consequently are beyond comparison with the intention to provide for sufficient space for modern technologies. This good intention can be realized otherwise, than the manner which contributes to undeserved and reasonless enrichment of some former leaders.

As form of agricultural organization, most efficient is the peasant farm based on the private ownership and family labor. The development of the peasant farms can be implemented through association based on market economy principles, as well as through “growth”, through accumulations of farming land and capital. The extension of the agrarian areas, concentration of plots, can be obtained through the lease of land shares. This model of extension has been known since the past century. In 1964, when the first agrarian reforms were launched, Ion Ionescu worked out the “Advises for owners who lease out their land areas”, advises that are still actual to nowadays. It is necessary to encourage this form of extension of the agrarian land. The extension can also be reached though sale of land plots.

Although the Constitutional Court through its resolution dated October 2, 1996 cancelled all the restrictions in realization of the right to land ownership, the land market has not been formed yet.

Regulations and considerations of the market relationships mechanism. Starting from the consideration, that the market is the economic area where the overall relations and exchanges are taking place, formation of market relations means first of all creation of an efficient economic system, which assures the liberty of the activities oriented towards consumer. Production of food products was and continues to be the support of the human beings. The agricultural products are destined basically to internal consumption.

The consumption of the food items per capita in the Republic of Moldova has an obviously declining trend. For instance, meat and meat products consumption in 1996 accounted for 43% of the 1990 level, milk and dairy products – 53%, eggs – 57%, sugar – 40%, vegetal oil – 58%, vegetables – 58%, fruits, grapes and berries – 75, bakery products – 74%.

Expressing the human needs, the consumption is determined by the capacity of the people to buy products. According to the statistical bulletin, the amount of arrears for labor payment on June 1 constituted 455.9 million lei, the amount for pensions and indemnities as on July 1 amounted to 290 million lei.

The lack of solvable demand increases under-nutrition. The daily amount of calories due to a member of household, are reduced from 3281 in 1980 to 2969 in 1990 and 2353 in 1994.

The traditional agricultural products are an important item of the Moldovan exports. Normally are exported the food items which exceed the needs of the respective country, although the share of products for domestic consumption do not indicate obligatorily the share of respective country participation to formation of the external market of food items. The volume of exports can be considerable even when the domestic consumption is not assured.

Table 2

Indicators	1991	1992	1993	1994	1995	1996	1997
Total export	8.1	64.9	701.9	2318.6	3349.2	3662.1	4044.4
Including agro-food products	3.7	25.8	337.5	1605.9	2478.4	2747.0	3306.4
Total imports	8.4	92.9	909.1	2692.2	3784.8	4935.9	5417.9
Including agro-food products	1.1	13.3	155.9	219.6	327.7	673.9	719.5

The share of agro-food sector in the overall exports of the Republic of Moldova increased from 45.7% in 1991 to 81.7% in 1997. This growth is due to the disaster in the industrial sector, and not to additional efforts of the farmers. The export of the agricultural products rose even if their production volume considerably fell. Important for the producer is to insure the prevalence of exports upon imports of agro-products. In our republic in 1991 the import accounted for 29.7% of the exports of the food items, in 1997 – 23.5%.

The strategy of formation of the food market should encourage the export of traditional food items, like grapes and wine, fruits and juices, vegetables, tobacco. In rest, the agriculture should satisfy the needs of the domestic market.

The fundamental instrument of regulating the market relations continues to be the price. For supply, the price has as cornerstone the cost of products, whereas for demand – the utility of the commodity.

The prices of the products consumed in the agriculture have increased much more rapidly. For example, the general indicator of the agricultural products in 1992 as compared to 1991 increased by 1017%, of the energy products – by 2900%, thus forming a ratio of 1:2.85; in 1994 this ratio was 1:3.17. This trend is maintained. The price index of the agricultural products in 1997 on average increased as compared with 1996 by 1%, for industrial products – by 20%.

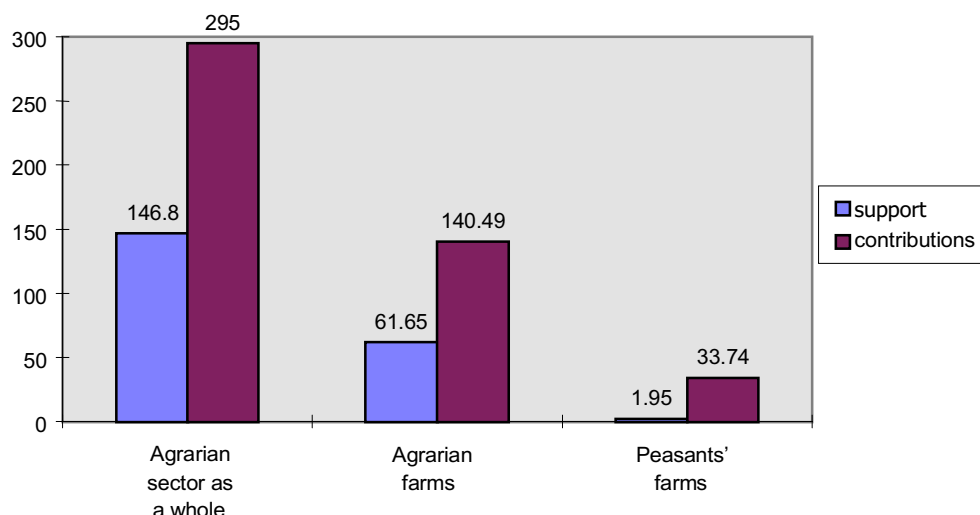
The prices of agricultural machines and equipment increased considerably, as well as those of the energy resources.

The cash incomes of the population have a much less rising rate. The share of labor payment in these incomes has declined from 73% in 1992 to 34% in 1997. The share of costs for food items rose in the overall costs from 38% in 1990 to 86% at present. Consequently the situation on the food market aggravated even more, which imposes the intervention of the public authorities through mechanisms adjusted to those conditions, by way of taxes and subsidies.

5. Agrarian reform: years of aspiration

According to a study of the taxation system and subventions to agriculture, carried out in 1998 by the ASA Institute on Analysis on Sectors and Policies Development, “On the one hand the share of this sector contribution to the state budget is lower than the share of agriculture in the GDP which speaks of a relatively low taxation. On the other hand the tax burden is not equally balanced, particularly between the peasant farms and other types of farms”. The agricultural sector makes a net contribution of 118 million USD to the state, of which approximately 32 million derive from the peasant farms.

Balance between the contributions to the budget and support from the state for agriculture.



Obviously, the financial support granted by the state for prices protection in the agro-food sector is extremely reduced due to the fact, that the budget, to great extent, is formed from this particular branch of the national economy. The total contributions fixed for agriculture amount to 797 million lei. Yet, there are indirect collections through VAT and excise duties from tobacco products, wines and other alcoholic drinks, etc. In 1997 the overall VAT and excises to the budget accounted for more than 48%.

The public authorities might also resort to capital investments.

Table 3.

Capital investments in agriculture /in current prices/, million lei

Indexes	1990	1994	1995	1996
Investments in fixed assets per productive objects	1.10	87.7	90.7	96.6
Including: state owned	0.53	31.5	25.5	23.8
Investments in fixed assets per non-productive objects	0.34	115.5	85.7	71.5

The investments in fixed assets for productive objects are growing. Yet, the state contribution is declining and in 1996 accounted for about a quarter, in 1990 – about 48%.

The capital investments in agriculture in 1996 reached the share of about 20% of those realized in the national economy as a whole.

Bank loans might contribute to improving the situation. Nowadays in the republic operate 22 commercial banks, which in January-November 1997 made loans. In the overall loans the share of long-term credits is decreasing, from 27% in 1990 to 8% in 1997. This impacts negatively upon agriculture, which is objectively depending on the biological factor.

Extremely dramatic is the situation of the newly land owner peasants, who practically have no access to credits.

The lack of resources contributed to reduction of chemicals usage, from 217.2 in 1992 to only 13.5 thousand of active substance in 1996, to renouncing to use other important factors for effective technologies.

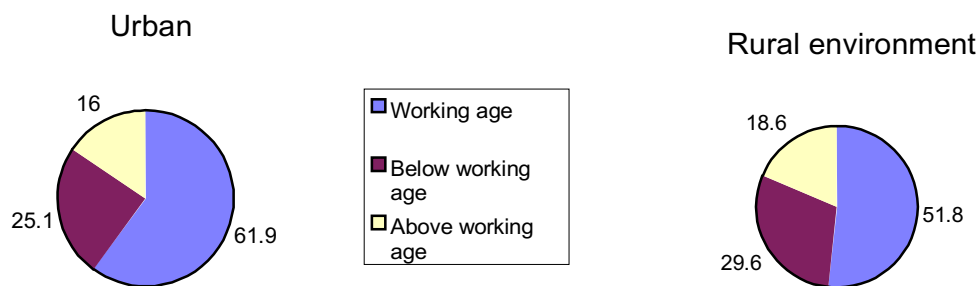
It is imperiously necessary the formation of an ample strategic program, oriented to the market economy requirements, for supporting the private sector and which might substantially contribute to acceleration of the agrarian reform.

Social aspirations of the rural community. The rural world manifests its specific traits in the habitat, on cultural values, on cohabiting norms, on traditions.

The fundamental change of the structure on land ownership, liquidation of old organizational structures, creation of family farms and other forms based on the private ownership, dismantling of the command administrative system and formation of relationships adjusted to market economy justifies the adoption of the living standards to the evolution of the rural community values.

As of today, the rural population constitutes about 55% of the overall.

The structure of the stable population, as on 01.01.1997,%



The economically active population from the rural localities accounts for 51.8%, in the urban ones – about 62%.

The crisis phenomena generated stoppage or liquidation of some economic units from rural localities, gave an impetus to the process of employees dismissal. In the raion Straseni, for example, of those 55 thousand able persons employed on the territory of the raion, remained only about 19 thousand individuals. Of course, the incomes condition the way of life, and contribute to the satisfaction of elementary physiological needs: feeding, clothes, housing, etc.

In 1996 the degree of insurance of the population from the urban localities with housing was on average of 17m² per inhabitant, in the rural localities – 22.4 m². Yet, the degree

5. Agrarian reform: years of aspiration

of insurance in the urban localities increased in comparison with 1990 almost by 20%, whereas in the rural places – only by 6%.

Distribution of households according to the size of average cash income available per individual, %

Monthly average cash income per person, lei	Total Households		Including			
			Urban		Rural	
	1995	1996	1995	1996	1995	1996
Under 108	68.4	57.7	56.9	40.3	79.9	75.7
108-216	25.6	31.8	34.8	42.7	16.2	20.3
26-324	4.7	6.7	6.4	10.1	3.3	3.4
Over	1.3	3.8	1.9	6.9	0.6	0.6
Total	100	100	100	100	100	100

Formation and generation of the social equilibrium presumes creation of conditions necessary for any citizen. Is that equilibrium observed? Only the apartments supplied with natural gas in 1996 in the towns constituted 281.6 thou, in rural localities – 47.3 thou, or almost 6 times less. The situation is similar in terms of other indexes too.

Focusing the attention on the fundamental event – incomes, pondering on some needs' components is stirred by the their influence upon the birth rate, natural growth, migration, etc. In the urban localities the natural growth per 1000 inhabitants in 1980 constituted 11.3, in 1990 – 9.3, in 1996 – 0.6, whereas in the rural localities these numbers were respectively – 8.6; 6.6 and 0.4.

Being aware of the traditions from our country, there were no efforts made to develop the rural community, for realizing the measures specified in the concept of the agrarian reform, aimed at setting up a social protection system, for developing the economic and social infrastructure. The transformations in the rural economy impose the development of the social components of the villages.

Professional education and investigation – extent of the reform. On July 1, 1998, according to the statistical bulletin, only 227 thousand persons, who constitute approximately a quarter of those entitled, received the land shares in private ownership.

Both promotion of agrarian reforms, as well as the activity in free competition environment, conditioned by the substitution of the centralized planning with market economy mechanisms, objectively requires people with proper thinking. The efficient activity of these people and of those who became peasant farmers, substantially depends the level of training, of the structure of accumulated knowledge.

In both the local and central public organs, including in the Ministry of Agriculture, there are occasional people, who have neither professional background in the field nor ever acted in the agro-food sector.

Unfortunately specialists with mentality formed in the command administrative system, with experience in the totalitarian regime, also got there. Important is that these people even do not want to give up their principles. Subsequently, they procrastinate even more the reforming processes and considerably contribute to diminishing the performances of the private sector.

Based on the analysis of the reforms regarding the knowledge, skills, professional level of those who obtained the land shares in kind, we notice a modest level in technologies and insufficient professional training in the fields of law, economy, banking, food market formation.

The training institutions, numerous projects and professional training cycles carry out their activities based on the poorly correlated programs and almost improperly adjusted to market relationships. The material and training conditions often are poor. The exposed materials are very general and very abstract for being applied in practice, which aggravates even more the employment of human resources and imposes perfecting the training system, as well as the formation of a human potential with sufficient training for activity in actual conditions.

Formation and perfecting the stuff of the agro-food sector became an imperative of the period we are going through. The experience of the highly developed countries confirm, that the professional growth is a profitable investment.

Modernization of agriculture, changing the relationship labor-land-capital, promotion and support of the reforms are possible by way of investigations. The existent system of agricultural researches leaves much to be desired. Multiple programs oriented towards the agro-food sector have a poor performance, because many of the invited experts do not take into account the economic force of the system in course of disappearance, of this hard reality which does not match with the western models.

In order to orient the behavior of the agro-food sector and agricultural processing industry, in order to justify the researches aimed at providing for scientific support of the agrarian reform, it is necessary to monitor all the components of this complicated process, such as the reform of the agro-food sector.

Final considerations. The main idea is that the agrarian reform which was launched as an imperative of the time and became irreversible. The fundamental strategic objective of the reform continues to be slowing down the decline, avoiding the misbalance between the demand and supply of food products, resolving the problem of the food security.

The agrarian reform has some more speeds. Each element of the reformation system has its own speed, which lead to discrepancies and contradictions. Speeding up the process of modification of property structure as factor of extending the responsibility and promoting competition. Formation and consolidation of the peasant farms, based on the family labor and their association for an efficient usage of the natural, human and material resources.

Development of market institutions in agriculture, adjusting the fiscal system, providing the access to loans, subsidizing agriculture, resolution of the social problems of the countryside. All of them comprise the imperative of the agrarian reform.

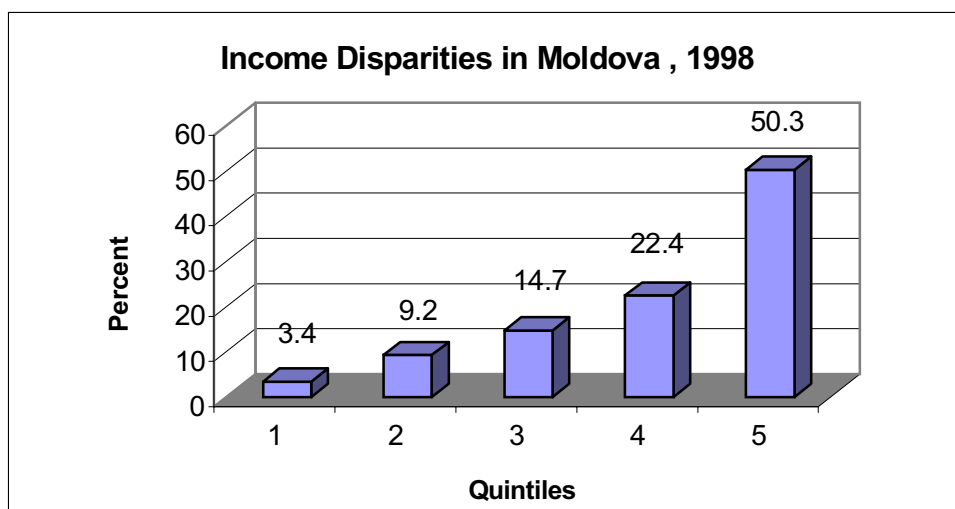
Finally, we consider the necessity to harmonize the elements of the agrarian reforms and large scale implementation of the general possibilities for interaction of the agro-food system components.

6. Social dimensions of the economic reforms

Social Implications of the Transition. Economic reforms are designed to improve people's living standards. A retrospective analysis of seven years of transition attests to a *deep worsening of all parameters of the quality of life*. The social sector is not able to provide an adequate protection against social risks. The situation registered at the end of 1998 confirms that activities in the social sphere are running inconsistently and with a low efficiency. The reality of the transition has been quite different from what was envisaged during the period of "romanticism" in the early stages of reform, which overestimated the speed and underestimated the costs of transition. The fall in GDP accompanied by a tough monetary policy has entailed significant social costs, which have been rising during the period. Their adverse impact has been felt by the whole collectivity, but it was (and will continue to be) especially painful for the elderly, the disabled, families with many dependent children and other vulnerable groups. In this sense the burden of the economic reform is borne by the people with low incomes, who in fact are in greater need of social protection. Consequently vulnerability and dependence are growing. This fact is confirmed also by the opinion poll made recently by the INSOC-Market, which indicates that only 5% of the population has benefited by the reforms, while about 70% of the respondents said that their living standards have been worsening.

The social implications of reform have a spillover effect onto all components of quality of life, *deepening social polarization*. Massive liberalization of economic activity at the early stage of reform, accompanied by widespread hidden unemployment and salary debts has considerably decreased people's real income. According to some estimation the magnitude of this fall was of approximately 70 percent. As a result poverty has been growing significantly, which leads to a deeper social inequality. The Gini coefficient, which measures the dispersion in the distribution of incomes, increased from 0.34 in 1990 to 0.61 in the first half of 1998 (for comparison, Western countries have Gini coefficients of about 0.35; in Poland, Hungary and the Czech Republic they are about 0.43).

As a consequence of this process, *income inequality* is increasing in Moldova. According to household budget survey data, by the end of 1998 the total income received by the richest 20 percent of the population was 14.7 times the income received by the poorest 20 percent, which compares with a figure of 12.25 three years ago. Today the richest one-fifth of the population receives roughly half of the total disposable income, while the poorest one-fifth has only 3.4%. People with middle income who constitutes the main share of the society (3/5) receive about 46% of the total disposable income. This is a clear indication that the middle class in Moldova is still too fragile to offset the social costs of reform.



The reduction in purchasing power led to a substantial shrinkage of individual consumption. From a society with a scarcity of consumption goods on the market Moldova has become a society with low individual consumption. All components of consumption decreased (foodstuff, durable goods, and services). However, the most significant fall was registered in basic foodstuffs, namely meat –minus 57%, milk – minus 49%, and fish- minus 84%. Consumption is now close to the critical limits, threatening people's normal development as human beings.

Malnutrition affects today not only people with low income, but partially also those with middle income who are employed in the budget sphere (teachers, public servants, medical workers), due to frequent delays in paying wages. According to household budget survey findings, in 1998 the average daily nutritional value per person amounts only to 1976 kcal. This is much less than the minimum nutritional threshold calculated by FAO, of 2100 kcal per day. Thus malnutrition in Moldova is spreading swiftly, compromising the security of nourishment.

The implicit effect of malnutrition has been felt in demographic aspects and the state of the population health. Comparative with 1990, the general death rate has increased by 15% while the birth rate has dropped by 38%. In 1998 for the first time in Moldova the death rate has exceeded the birth rate. Consequently the rate of natural increase of the population has become negative (-0.2 per thousand). This could have a long-term impact on depopulation in Moldova. Complementarily, morbidity, which stays high due to widespread chronic diseases, such as black lung, digestion pathologies, tumors, and cardio-vascular diseases, could exert a great impact on the further human development in Moldova. As a result the demographic dependency ratio is rising which could become a real hindrance for the economic reforms. Now the scope of this phenomenon is much higher than the critical limit (0.11), accounting for 0.31.

The cumulative effect of social costs is reflected in the Human Development Index (HDI), which contains a synthesis of demographic parameters, performance of education, health, and living standards. This index is computed by the UNDP and serves a basis for comparative international analysis. Based on estimations made by the UNDP, Moldova in 1992 held 75th place in the world, achievement which was quite good for that period of time. However, Moldova has since experienced a deep fall in this index, which puts it on 113th place in 1997. Of former soviet republics only Tajikistan, in the 118th position, is behind Moldova in this international rating. The low value of HDI constitutes a warning of difficult situation that persists in the social sectors. The main indicators of in the social sphere are at critical level and could undermine further development of economic reforms, and even put into great danger the *economic security of state*.

The magnitude of the social implications is conditioned mainly by the legacy which the social sphere inherited from the old system. Being completely financed from the state budget, the social sphere was designed to provide services to the whole population regardless of the recipients' level of income and their degree of need. Social commitments had a universal character, and included a wide gamut of benefits, which covered life's ordinary contingencies, i.e. aging, temporary loss of work capability, childcare, entertainment and others.

Social Indicators of Economic Security

	1990	1997	Recommended***
Life expectancy, years	68.5	66.6	
for women	71.8	70.3	
for men	65	62.9	
Birth rate, per thousand	17.7	11**	
Total death rate, per thousand	9.7	11.2**	7-8
Natural increase, per thousand	8.0	-0.2**	
Infant mortality, per thousand	19.0	19.9	10
Fertility coefficient, number of births	1.95	1.667	2.1
Net reproduction ratio, %	93	77	100
Official rate of unemployment, %	N/A	2.3**	5
Hidden unemployment, %	N/A	15.5**	0
Rate of employment of labor force, %	80.7	45**	65-70
Share of foodstuff expenditures, %	34.5	67.9	25-30
Value of nutrition, kcal/day	2969	1976	2100
Social polarization of population, times	N/A	14.7**	5-8
Gini coefficient	0.34*	0.61	0.25-0.3
Coefficient of demographic dependency	0.28	0.31	0,11
Coefficient of social dependency	0.44	0.69	0.2-0.25
Share of social expenditures, % of GDP	18.4	24.8	15
Including for health care, % of GDP	3.8*	5.9	8-9
Annual average health care expenditures per person, lei	N/A	114	210
Including for education, % of GDP	7.8*	8.2	5-6
Annual average expenditures per scholar, lei	N/A	1807**	2460
Pension expenditures, % of GDP	6.1*	9.7	10-11
Rate of salary replacement by pension, %	59	29**	33-35

*- 1992

** - 1998, first half

*** - according the criteria set by the international organizations (UN, IMF, WB).

N/A - data not available.

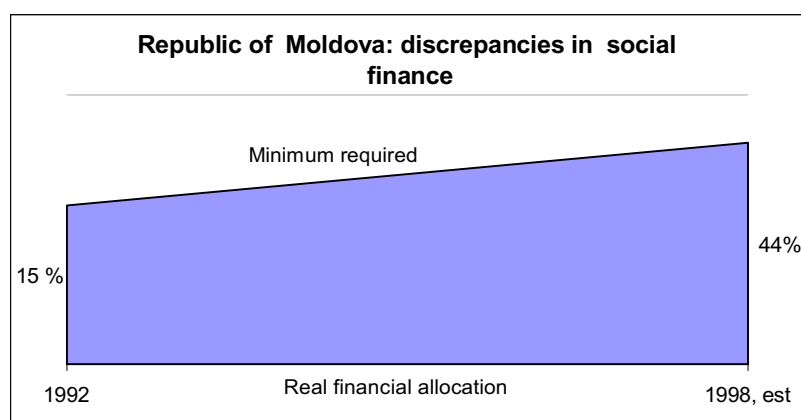
Free universal access to medical and educational services has been intensifying the tendency of their exaggerated growth in volume while they have lost considerably in quality. Thus, on quantitative parameters (number of physicians, beds in hospitals, pupils in schools, and teachers) Moldova could compete even with some of the Western countries. At the same time, however, quality leaves much to be desired.

A significant role in the traditional system of social benefits was attributed to indemnities and compensations in cash. Having as a major purpose the avoidance of excessive income disparities, cash transfers were provided for covering trivial situations, like housing, public transportation, communal services and others. Very often the same person could receive several cash benefits from different sources (state or local budget, social fund) for the same case. *Overlapping and easy eligibility criteria* led to a substantial increase in their number. By mid-1997 there were about 250 types of income transfers. Although measures undertaken further on this issue have reduced to some extent the number of cash benefits, yet their burden remains heavy. At the end of 1998 more than 1 million people in Moldova have been provided with cash benefits, with an estimated value of 1.1 billion lei.

At the same time the *diffuse character of social transfers* has been aggravating their dispersion. Often it is the non-poor groups that have received these benefits. According to household budget survey data, in the first half of 1998 around 1/3 of total social benefits went to rich groups (4th and 5th quintile). This is a good reason to argue that income transfers should be better targeted and provided on basis of means testing. Thus the poor still remain the most vulnerable point in the social assistance system.

Besides that, a large share of social services were provided at the micro level by the enterprises. Using the diverse social institutions (kindergartens, dormitories, sanatoriums, and others) belonging to them, enterprises were able to provide *fringe benefits* to their employees in addition to those benefits received at macro level (from state budget or social fund). Some sectoral findings show that the share of fringe benefits was significantly in electrical industry, chemistry, manufacturing and other branches. Their value could reach 20% of the gross value of wages. Interlacing of fringe benefits with those provided by the state caused fragmentation of the social system, making its management less efficient.

Universal coverage and unclear eligibility criteria have been generating an *explosive increase of social cost*, which constituted a heavy burden for the economy. During the 90s the share of social expenditures increased by 35%, until it represented, in 1998, 1/5 of the GDP. Economic recession accompanied by the fiscal crisis has been eroding the support of social inflows, undermining significantly the sustainability of social finance. Misallocation of resources in concert with low rate of contribution collection has widened the discrepancy between social commitments and financial possibilities. From 15% in 1990, the gap between real allocation of financial resources and the minimal required level reached 44% in 1998. It became as



a common norm chronically delaying in paying wages, pensions, indemnities and other social

benefits. This is a sign that the viability of social finance is on edge of crisis.

It became clear that further maintaining the social sphere in its initial scope and structure is an inadmissible thing, which could constitute a serious impediment for economic transformations. Financial disbalances and disfunctionalities in social sphere activities could lead to a further grow of the burden borne by the economic active population. The coefficient of social dependency grew from 0.44 in 1991 to 0.69 in mid-1998. Today for each 100 people employed in the economy there are 76 beneficiaries of social sphere (pensioners, children, disabled). The practical evidence suggests that for a normal situation this ratio should be 100 to 25. Hence reforming measures should cover all elements of social sectors, namely finance, the structure of benefits and institutional network.

Conceptual Pattern of Social Reform. Although the necessity of reforming the social sectors has been recognized from the beginning and was included in all governmental programs, practical actions undertaken in this regard are too modest. The sensitivity of the social sphere has determined the nature of the conceptual pattern of reform. Having as a major aim provision to all people a decent level of life (objective that is very noble, but not feasible in the current conditions), policy makers plunged into long theoretical disputes about the scope of social reform. Discussions about paths of reforms emerge even now after seven years of transition. Thus the *theoretical aspect of reform prevailed over the pragmatic one*. Consequently, remedial action had a low efficiency.

Apart from that, it was mainly the political environment that conditioned procrastination of social transformations. Affecting foremost welfare of people with low and middle income (who traditionally are the most active part of electorate), social issues have started to be used more frequently by the political parties in their own interest. Social transformations were turned into political issues. *Pressures exerted by the politicians* usually are much greater than real possibilities. As a result promises made during the elections remain unfulfilled. Thus the political populism that is quite common nowadays has a significant adverse impact, lessening the credibility of people in reforming the social sphere.

The unsustainable effects of the environment are amplified also by the inconsistency of political will which is manifested by the policy makers. Being constrained by the financial turbulence and by the excessive polarization of the collectivity, policy makers give preference to scenarios with less degree of risk. Thus so far they have stressed partial and piecemeal reforms, which according to empirical evidence from other countries in transition are more painful and costly for the society. Furthermore, changes made very often in the structure of government have been eroding the political and administrative support for the social reforms. The lack of a main political guarantor who will assume full responsibility for the scope and aims of reforms of the social sphere was undoubtedly a factor of the insignificant progress registered until now in the activities of social sectors.

The major reason in spreading the crisis situation in the social sphere was the lack of a clear and feasible strategy, which should be supported by a set of successive and coherent practical activities. What has been done during seven years could be described as a combination of fragmentary measures, implemented in a sporadic and ad-hoc manner. That can be attributed to the numerous recalculations of pensions and indemnities, unsuccessful attempts at introducing fees for medical services, shallow phasing out of subsidies and others.

The main disadvantage of such measures is that they attack only one part of the issue

(more frequently this is the financial one), neglecting other sides of the problem (setting policy agenda, benefits structure, institutional network, strengthening administrative capabilities). As a rule such interference is essentially passive, because is not able to anticipate the events, and it is set up after they have emerged. Obviously, performances are insignificant and do not contribute to the social cost reduction.

The 1990s were characterized by a regrettable inconsistency in formulating strategic guidelines for social reform. Each time a government made changes, it also carried out a complete overhaul of the social policy elaborated by the previous governmental team. Usually new government came up with an absolutely new social concept, completely different from the previous one. For instance, at the initial stage of reform (1990-1993) social policy envisaged a massive indexation not only of pensions and salaries, but even of people's savings deposits. Later on this concept was revised as to being too costly. It was replaced by the concept of partial selective and regressive indexation. The same thing happened with nominal cash compensations: sometimes they were cut or postponed, sometimes provided again. These broad changes in concept have further complicated the situation, deepening confusion at the implementation stage.

The analysis of social policy shows that in the conceptual pattern of reforms of the social sphere, *financial approaches prevail*. Being concerned mainly with maintaining the financial situation, policy makers have laid stress on reducing public social expenditures. By the way, at the early stage of reform (1992-1994) even missions of the international financial institutions (WB and IMF) endorsed with some reservations these positions. The cost-saving model has been largely implemented in all sectors of the social sphere: health care, education, social assistance and others. The budgets of these sectors are revised several times during one fiscal year with a view to cutting expenditure. An eloquent example of this is the budget of the social fund, which was revised three times during 1998. By comparison with the initial version at the beginning of year, expenditures from this fund were reduced by 24%. For 1999 the social fund budget will be shrinking further, accounting for only 85% of the final budget registered at the end of 1998 year.

Thus the austerity in allocating financial resources to the social sphere increases and becomes more common. Of course, restructuring social finance is an important point for the reform and gives explicit short-run outcomes (avoidance of misallocation, containing costs), which are very relevant at this critical moment. But these measures could have an adverse impact in the long run. Financing health care and education only in proportion of 45% we can be sure that the morbidity and mortality will increase, holding back normal human development in Moldova. The same can be said about social benefits (pensions, compensations, indemnities), which form the main sources of income for the poor people. Cutting their size might affect directly the welfare of vulnerable groups, extending "poverty pockets". From this point of view the cost-saving approach cannot be justified as the single method to deal with reform of the social sphere.

Main Peculiarities of Conceptual Pattern in Reforming Social Sphere

<i>Classical Method</i>	<i>Case of Moldova</i>
1. Systemic approach 2. Trade off between efficiency- social equity-political feasibility 3. Strong stable financial support 4. Social cohesion of the community 5. Continuous improvement of practical performance 6. Unity in concept-policy-programs 7. Succession and continuity in the strategic line 8. "Policy window "is open 9. Equitable distribution of social costs	1. Unilateral approach 2. Rely on cost-saving methods 3. Financial unsustainability 4. Strong pressure from the opposition and community 5. Inconsistency in implementation 6. Discrepancy between concept and administrative capabilities 7. Fragmented and sporadic character 8. Tough political and administrative constraints 9. The burden of social costs is borne mainly by the poor groups

The principles of social sphere reform should satisfy the following three criteria: *economic efficiency, social equity, and political feasibility*. In the case of Moldova from the beginning the reform of social sectors was wrongly conceived, giving priority to financial aspects. Financial indices have been taken as an indicator of successful performance. Overlooking of modifications of the structure of benefits and the institutional network has caused substantial distortions during this period. Consequently, people's anxiety has been growing to the point of becoming an impediment to the reform. Trying to rectify errors made, policy makers have relied only on the distribution principle, which in our difficult situation deepens social polarization. As a result, fiscal evasion and income hiding (unregistered wages) become wider, threatening the future development of reform.

Undoubtedly, not all of what was done so far in the field of social reform can be seen as negative. There were some significant achievements. Of course, people want to benefit from the results of reform as soon as possible, and in a tangible form (increases in real wages and pensions, cheaper goods, accessible social services and others). Social changes, by their nature, *affect people's welfare today, but bring benefits after a certain period of time*.

Nevertheless there have been *some beneficial outcomes* from the social reform. It is worth mentioning in this context the availability of goods which has increased significantly during the 90s. This fact extended the choices and opportunities of people as consumers, reducing the time they spent in queues. The grade of imperfect substitutions, which is typical of the old economic system, has decreased. Market determined wages together with harder budget constraints have improved work incentives. Even if this deepens the differentiation in remuneration, the beneficial effect is significant: more productive and more qualified work has come to be paid higher than previously. At the same time the structure of peoples' income has changed substantially, driven by the market forces. The share of salaries in the total income has fallen from 74.5% in 1991 to 36.8% in late 1998, while the slice which comes from entrepreneurial activities increased. This fact has reduced the grade of dependency of income on salaries, making possible more flexible adjustment of wages level to the market requirements.

Although the progress registered in the education sector is still modest, we can find here some beneficial outcomes. They refer first of all to improved access to foreign know-how and the Internet. Additionally the opportunities to study abroad in prestigious western universities have increased. Slowly but consistently, private forms of education affirm themselves. In 1998 one out of five students was studying in the non-state private institutions. As a result, the financial sources of the educational system become more diversified. At the end of 1998 the non-state private sources of finance accounted for 10% of total expenditures for the education sector.

On the labor market occur processes which increase the flexibility of labor actors. Professional and territorial mobility has increased, which has a positive impact on the equilibrium between demand and supply of labor. Initiative and entrepreneurial talent becomes more significant for labor relations. The role of the private sector in creating new jobs is becoming more relevant. In the first half of 1998 about 1500 new jobs were created in enterprises with foreign and mixed capital, which is more by 1.4 times than in the private sector. Labor migration is increasing, although with some deficiencies. At present Moldova has bilateral conventions with Poland, Romania, Israel and many of the NIS regarding labor migration procedures.

Health care and medical assistance began the process of reform later than other social sectors. Ongoing restructuring has been dealing with all parts of this sector. For this reason it is too early to find some tangible benefits. They will be felt in the near future. For now we can mention the following results. The legislative pattern of reform was elaborated, which includes the Concept (adopted on July 17, 1997), law on compulsory medical insurance (approved on February 27, 1998), and a number of normative acts on restructuring the institutional network and optimization of expenditures. Gradually it is passing to the primary medical care through setting up the institution of family physicians.

In the field of social assistance, benefits still remain intangible, i.e. they do not have a clearly measurable value. The outcomes registered by now rather facilitate the promotion of reform, because their aim is to create a sustainable environment. In this sense we should mention phasing out some social facilities, tightening the eligibility criteria, improving the link between contributions and benefits. As a positive achievement could be mentioned the approval by parliament of the law on state pension insurance (October 14, 1998), and passage for examination of another set of legislative acts which will intensify the promotion of social reform. Unquestionably, a more realistic social fund budget, passed by the parliament, will exert a positive effect on the whole speed of reform.

The outcomes achieved so far could be considered as a first step on the long and controversial path of reforms. They indicate that the vector in general is set up properly. The real situation shows that the *most difficult part of this job still remains to be done*, as is indicated by the large gap between progress and planned objectives. Deterioration is typical for all social sectors. In health care, morbidity and chronic pathology are increasing sharply. The rate of maternal mortality still remains at a high level (48.3 per thousand). Each third child is born with pathologies at birth. In education the number of pupils which do not go to school for reasons of poverty is growing. In 1998 their number reached 10 thousand children, against 3900 in 1996. Huge salary and pension debts, accompanied by the poor collection of social contributions (15-20% of the daily necessity), complicate the situation which now faces the social sphere. Thus the implementation of measures that will improve the situation and also facilitate reform is urgently required.

Social Policy Agenda: priorities and succession. The vector of further actions should be oriented toward gradual reduction of social costs of economic reform and stopping the drop in living standards below the threshold of social security. Taking into account the scope of poverty, which affects almost 2/3 of the population, priority should be given to programs of poverty alleviation as the most important issue for the short-run period.

Social protection of the poor groups should be the main concern on the policy agenda for the next couple of years. Policy in this field could combine two elements: active measures and passive measures. In the first case the accent must be put on the promotion of economic opportunities for the poor by creating low paid jobs, diversifying the social infrastructure, and easing the access to credit. These could extend the possibilities of using more productively the only asset that the poor have in abundance - their labor force. In the second case significant progress could be achieved through the social assistance system network. Providing basic social services (access to elementary education, primary health care, nominative indemnities) would cushion to some extent the burden of social costs that is borne by the most vulnerable groups. For the passive policy and particularly for the poverty indemnities it is important to provide benefits on the basis of means testing, improving sharply their addressability.

With respect to the policy of reforming the social sphere we consider that reforms should be classified into short term activities (implemented as a matter of urgency), and activities for the medium term (strengthening the capability of social sphere). A hierarchical arrangement of priorities is not merely a theoretical exercise. It has significant pragmatic importance. Being implemented in a very turbulent environment and facing tough financial constraints, social policy thus feels the need to have a scale of social values. On this basis it should appreciate social dimensions of reform in order to avoid the dispersion and misallocation of resources. On the other hand this will allow to concentrate the efforts and limited resources on the most urgent problems, improving meanwhile the operational level of social programs.

The nature of *short term activities* confirms that they should be implemented in an operative regime and be oriented mainly to solving issues of a transitional nature which at the moment can undermine (or aggravate) substantially further promotion of social reform. These activities might have as a major objective the improvement of social finance viability, and could focus on the following:

- paying off overall pension and salary debt;
- avoiding a buildup in the current stock of pension and salary arrears and preventing it from occurring in the future;
- canceling the practice of payments in kind of pensions and salary;
- banning the use of netting transactions in relations with social fund;
- assuring timely payments of current pensions and wages with no arrears;
- increasing the level of contribution collection to the social fund, and tightening financial discipline;
- reducing former social privileges and improving the eligibility criteria;
- modifying the structure of social contributions in order to share more equitably

their burden between employers, employees, and state budget;

- assuring financing in full from the state budget for the minimum package of social services adopted by the parliament.

Medium term measures include a series of activities aimed at deepening the reform in all sectors of the social sphere. Their impact would have a long-run strategic effect and for this reason the benefits might be felt in the future, not immediately. The policy agenda for the medium term should cover in a balanced manner all parts of the social sphere activities, namely financial, structural, institutional, legal, and managerial concerning. Out of multiple strategic activities we might stress the following:

- building up a legislative pattern fitted to the requirements of the market economy;
- rationalizing the structure of social institutions and strengthening administrative capability.
- assessing the performance of social activities on the basis of western TQM standards;
- developing an alternative non-state sector for the provision of social services.

Implementation of social policy will happen in an unsustainable turbulent environment (at least for the short run). From this point of view some factors might cause difficulties to the normal running of things. These include:

- low rate of collection the social contribution.
- tough budget constraints which during the next period might become harder;
- weak administrative capabilities to implement the social programs;
- pressure exerted by the political opposition and the community might take larger proportions;
- weak political support from the parliamentary alliance.

Empirical evidence shows that the state play an important role in the promotion of social programs. Besides its traditional redistributive function the state maintain social cohesion in the society, facilitates the efficient promotion of market forces, and insures a minimum level of protection against social risks, which the private market generates. Following from this it is necessary to strengthen the role of public administration in the promotion of social reform. Today, after seven years of transition, we verify that the price of reform is too high, and this might substantially increase *social instability* in Moldova.

7. Pension system reform - first difficult steps

Pension schemes are the most important component of the social security system aimed at insuring and maintaining living standards of non-employed people and social vulnerable groups at a decent level. They consist of a set of economic, legislative, social and organizational measures.

Effective in November 1998 the pension system in Moldova comprises 756.7 thousand pensioners or 21% of the total population. Old age pension receive 557.2 thousand people, (of whom 150.9 thousand are privileged pensions), 113 thou–disability pensions, 34.9 thou-survivor pension, 38.8 thou-social pensions, and 4.2 thou-long-service pension. According to household budget survey data pensions amount for 10.5% of the people's global disposable income.

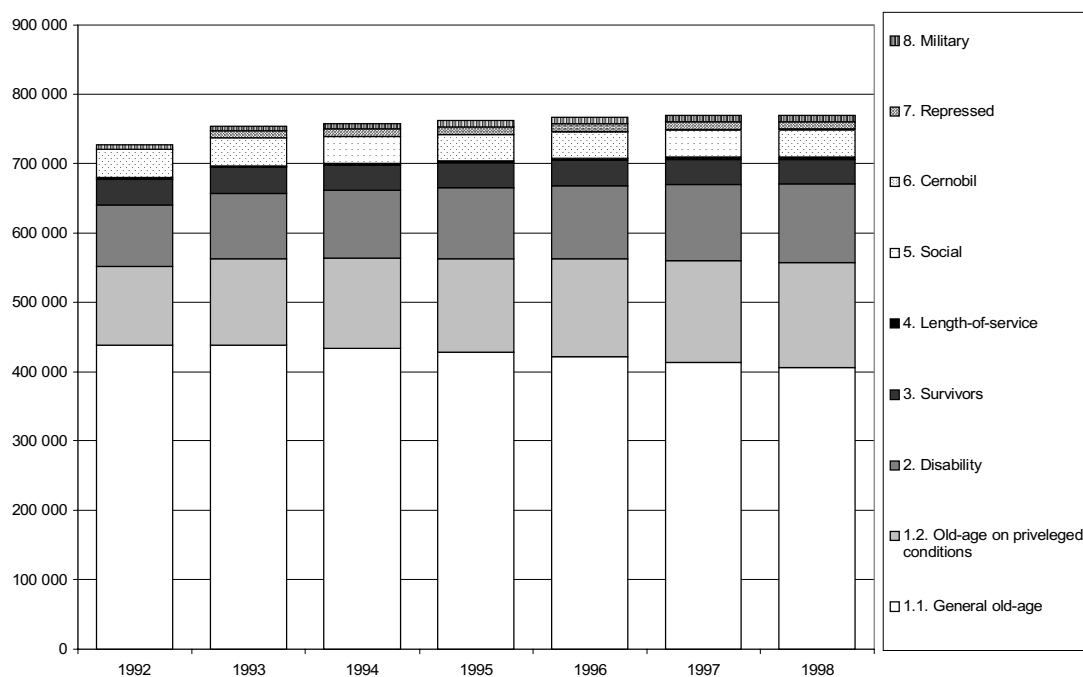
Analysis of the changes occurred in the structure of pension attests that over the last five years there was a significant decrease in the old age pension. Their share has fallen from 60.2% registered in 1993 to 54.6% in 1998. Meanwhile the share of privileged pension has increased substantially: from 15.6% to 19.5%. These shifts in favor of privileged pension have been pushing up the financial burden of the whole pension system.

Number of Pensioners in Moldova

Types of Pensions	1992	1993	1994	1995	1996	1997	1998
Total Beneficiaries	727 356	743 602	746 702	750 556	754 653	757 020	756 716
1. Old-age pension	551 443	562 298	563 982	562 954	562 688	560 439	557 237
1.1. Old-age pension for normal conditions	438 185	437 686	433 078	427 504	421 808	413 134	406 356
1.2. Old-age on privileged conditions pension	113 258	124 612	130 904	135 450	140 880	147 305	150 881
2. Total disability pension	88 561	94 983	97 602	102 255	105 623	109 219	113 012
3. Survivor pensions	37 791	37 552	36 388	36 223	36 351	36 334	34 918
4. Length of service pensions	1 970	1 939	1 847	2 286	2 892	3 799	4 181
5. Social pensions 1	40 535	40 282	38 819	38 003	38 267	38 430	38 827
6. Pension for participants to liquidation of consequences of explosion at Chernobyl APS		199	297	422	677	933	1 551
7. Pension for repressed people		10 000	10 730	11 220	11 442	11 448	11 365
8. Military pensions	7 066	6 548	8 064	8 835	8 832	8 799	8541

Breakup of Pension Beneficiaries

Types of pensions	1992	1993	1994	1995	1996	1997	1998
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total beneficiaries	75.8%	75.6%	75.5%	75.0%	74.6%	74.0%	73.6%
1. Old-age pension	60.2%	58.9%	58.0%	57.0%	55.9%	54.6%	53.7%
1.1. Old-age pension for normal conditions	15.6%	16.8%	17.5%	18.0%	18.7%	19.5%	19.9%
1.2. Old-age on privileged conditions pension	12.2%	12.8%	13.1%	13.6%	14.0%	14.4%	14.9%
2. Total disability pension	5.2%	5.1%	4.9%	4.8%	4.8%	4.8%	4.6%
3. Survivor pensions	0.3%	0.3%	0.2%	0.3%	0.4%	0.5%	0.6%
4. Length of service pensions	5.6%	5.4%	5.2%	5.1%	5.1%	5.1%	5.1%
5. Social pensions	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.2%
6. Pension for participants to liquidation of consequences of explosion at Chernobyl APS	0.0%	1.3%	1.4%	1.5%	1.5%	1.5%	1.5%
7. Pension for repressed people	1.0%	0.9%	1.1%	1.2%	1.2%	1.2%	1.1%
8. Military pensions.							

Changes in Number and Structure of Pensioners

The baseline of old age pension is set up at 55% of the average wage plus 1% of wage for each year in excess of 25 years of work for men and 20 years for women. Besides that, there are some compensations and supplemental payments envisaged by the law. Over 1994-1997 the size of pension has been risen several times due to the inflation. Main changes took place as follows:

7. Pension system reform - first difficult steps

1994 – increment by 10.80 lei as a result of price liberalization on basic goods and services; there were established differentiated nominative cash compensations of 8, 10, 13 lei with regards to the size of pension;

1995 – increase by 7.20 lei; pension indexation due to inflation;

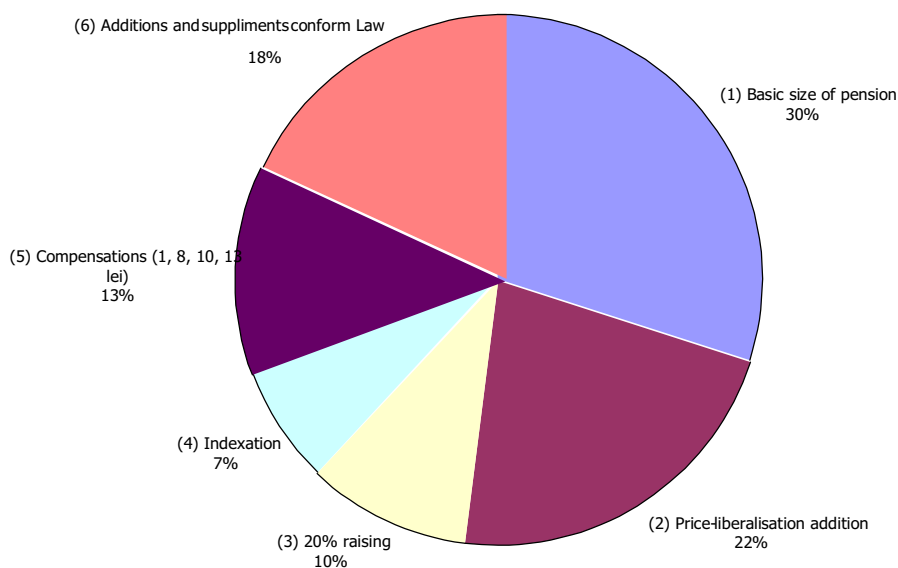
1996 – increment of total number of pensions by 20%.

As a result, all these changes have led to a situation when the basic size of pension constitutes only 30% of the total value of pension. This phenomenon has weakened the link between contributions and benefits. Using wages instead of contributions as a basis for calculating the size of pension undermines compliance to pay these contributions and pushes up pension arrears.

Even with these additional payments, average replacement rate has shrunk from 59.7% in 1992 to 37.7% in 1997. In October 1998 this coefficient constituted 32.2%. Consequently, the share of minimal consumer basket covered by the average pension has dropped significantly: from 18.8% in October 1997 to 16.6% in October 1998. The ratios of pensions increasing are much smaller than the ratios of salaries or minimal consumer basket. Thus, during 1993-1997 the minimal consumer basket grew up by 9.1 times, average salary-by 7 times, and average pension only by 4.4 times.

At the same time changes in the economy (entrepreneurial development, private sector growing, widespread of informal economy, building up of arrears) led to lessening of wages in the total disposable income of people.. The magnitude of this process is too wide: from 71.6% in 1992 to 36.8% in late 1998.

Breakdown of average pension and supplements



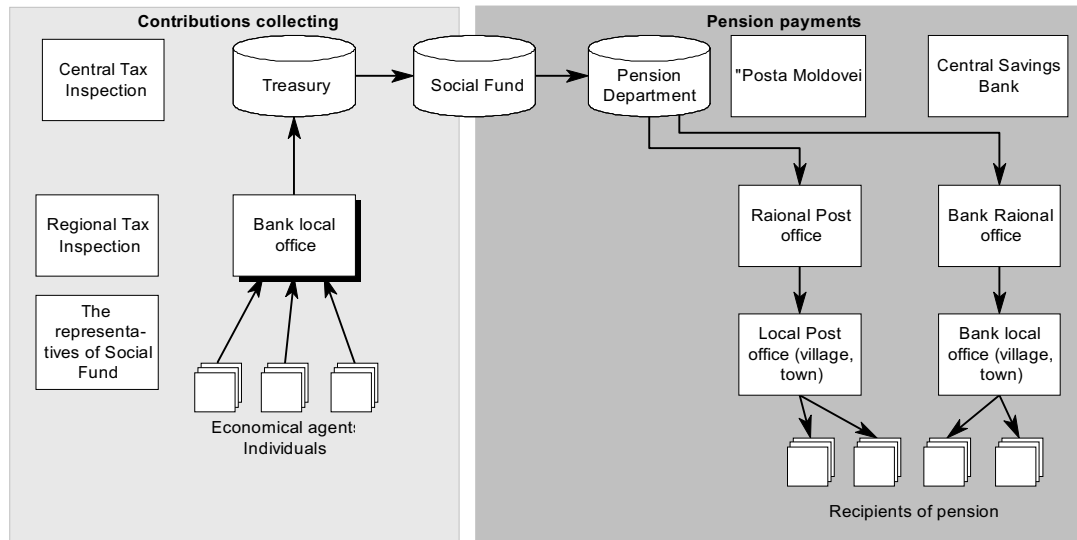
At present the *management of social security system in Moldova is too complicated* being run by a series of institutions: Ministry of Labor, Social Protection and Family; Administrative Board and Executive Division of Social Fund; Pension Department; Local Divisions of Social Protection. In the managing processes are implicitly involved Ministry of Economy and Reforms; Ministry of Finance; Ministry of Defense; Local Public Administration; Trade Unions, and economic agents.

Pensions and other social contributions are financed from the budget of Social Fund, which is formed from the contributions paid by the employers, employees, as well as transfers from the state budget. Although Social Fund does not keep an individual account of

contributions, nonetheless it keeps records on total sum of contributions collected to the Fund, and registers economic agents as contributors.

In managing activities many functions overlap, there is a lack of strict delimitation of authority and responsibility among the institutions/organizations dealing with social programs. Due to broad diffusion among institutions involved in managing of pension system, and also because there is a lack of legal regulations in their relations, it is hardly feasible to do an efficient control of collection and distribution of the social contributions.

The scheme of collection of the social contributions and their distribution is shown on the following figure.



Nowadays organizing the work on computing and paying the pensions is based on a high degree of centralization. Though in the past this system used to be sustainable and easy to manage (taking into account technical opportunities offered by PCs and financing from the state budget), at present it lost its advantages in many aspects and cannot assure an efficient solution for the issues related to the pension system management. Disadvantages of current system are as follows: long terms of processing the information database; big time lag (the process from the application presentation till pension provision lasts 2 months); this job requires large volumes of labor efforts and material expenditures; lack of an operative control at all levels; reduction of responsibility for performing well the work duties.

In the light of above mentioned the *main reasons for reforming pension system* are: failing in collection contributions to the Social Fund; building up of pension and other social arrears; decrease in the level of pension and social insurance; increase of the burden on active population of due to aging of population (calculations show that in the future the situation will worsen because of the high demographic dependency ratio), and also because of high share of privileged pensions; ratio of social contributions are high and split inequitable between employers and employees; high level of overhead expenditures; misallocation of available resources which does not allow to address them towards more needed people; loosing of linkage between contributions and benefits and lack of targeting in providing social assistance; interference of functions between social insurance and social assistance; non-adequate legal framework; low efficiency in managing social insurance system.

The on going administrative-territorial reform in Moldova represents also one of the reasons, which urged the necessity of transforming the management of pension system.

The purpose of new reformed pension system is to provide right benefits to the right

7. Pension system reform - first difficult steps

people, in the right form, and at the right time according to the principles of social justice, equity, individual rights, and responsibility in a transparent and sustainable way. Taking into account all these goals, the *main objectives of pension reform* are: to insure elder people with an adequate level of income; to improve financial sustainability of the system; to insure respect of social justice, equity and solidarity principles; to insure a greater recovery of the social costs by the social system.

Main directions of pension reform are as follows:

- Improvement of life standards of current pensioners;
- A new program for the future pensioners;
- A continuous functioning of the system during transition from the old to the new pension system.

There has been elaborated some legislative acts aimed at facilitating the pension reform. Among them: Strategy for Reforming Pension System (approved on September 23, 1998); drafts of Laws On State Pension Insurance; On Non-State (Private) Pension Funds; On Compulsory Social Insurance; On Social Fund. On October 14, 1998 the Parliament has adopted the Law On State Pension Insurance which will come into effect beginning with January 1999.

What is the reality of the pension insurance in Moldova? Failure in collection of social contributions has led to a build up of pension arrears. At January 1, 1995 pension arrears accounted for 128 m lei, in 1996-there were 315m lei, in 1997-23 m lei. Effective on April 1, 1998 pension arrears amounted to 212.6 m lei, from which 21.4 m lei for 1996 year; 48.2 m lei for 1997, and 142 m lei for January-March 1998 year. During January-July 1998 historical pension arrears have been reduced significantly: for 1996 –to 4m lei, for 1997- to 22 m lei. But the overall stock of arrears still remains big-290 m lei as of July 28, 1998.

In order to improve financial sustainability of pension system (and as a result to make better provision of benefits) the new Law On State Pension Insurance envisages:

- piecemeal reduction of early retirement (lists number 1, 2, and 3; mothers with many dependent children);
- increasing the statutory retirement age by 65 years for men and
- 60 years for women;
- ceiling pensions for elderly who combine pension with work activities.

Besides that, in order to achieve a sustainable financial basis it is necessary to put into effect a series of measures on preparing a more realistic and feasible budget of Social Fund; rationalizing the structure of expenditures and excluding from this system the items which are not related to the nature of pension insurance.

The international practice offers several types of pension insurance- PAYGO (based on solidarity principles) which is called *Defined Benefits (DB)* system; accumulation (or capitalization) pension which is known as a *Defined Contribution (DC)* pension system, and *voluntary savings and annuities*.

PAYGO system is publicly managed and based on intergenerational redistribution. Such system works well in countries with young population, but for countries with aging population (like Moldova) it would be inefficient due to an increasing burden on the social protection system.

Accumulation system (DC) is fully funded and is based on personal risk of contributors.

State is involved at a less degree in managing this system. Such system can operate well if there are developed and settled up the institutions of financial market, i.e. investment fund, stocks exchange and others.

Voluntary saving schemes constitute an intermediate chain in a pension system. They offer supplemental retirement income with the means and inclination to save more. It is based on supporting saving versus consumption and envisages creation of so-called quasi saving accounts.

The situation in Moldova shows that the most convenient approach is the multipillar system, which comprises public compulsory pension insurance and private voluntary tier. That is why in conformity with the Strategy for Reforming Pension System and Law On State Pension Insurance the current PAYGO system will be replaced by a system with three pillars which consists of minimal guaranteed pension, old age pension, and individual (private) pensions.

On the basis of the art. 12 of the Law On State Pension Insurance *minimal pension* constitutes the minimal sum which is guaranteed by the state to people who are entitled to receive the pension, but the effective size is less than the minimal level envisaged by the Law. In this case the minimal pension is set at 25% of the average wage in the national economy registered in the previous year from promulgation of the present law. Further the size of minimal pension will be indexed in accordance with the rate of inflation.

Old age pensions are based on insurance principles and are provided to those people who have accumulated the statutory years of contributions and the minimal income required by the Law. In this sense Law envisages that the size of pension is computed on the basis of the average insured income determined in compliance with the total sum of contributions made. The Law also envisages provisions about incentives for a late retirement, and extra work years added to the statutory number.

It is worth to mention that the new pension formula simplifies the process of its calculation, assures a tighter link between contributions and pension benefits, and increases incentives to late retirement. Besides that there were reduced non-insured periods of time, limiting to the following: a) compulsory military service within institutions of Ministry of Defense, Ministry of Internal Affairs, and Ministry of National Security; Department of Civil Protection and Emergency Situations; b) child care till age of 1.5 year.

Individual pensions are a type of voluntary supplemented to old age pension, and managed through private pension funds. Such kind of insurance runs nowadays the insurance company "Asito" but it covers only 3-4% of the total number of pensioners..

The main reasons which hinder the development of individual pension insurance are: lack of suitable legal framework; underdevelopment of financial market institutions; low level of income of the population; lack of credibility expressed by the potential clients towards various private funds.

Calculations made by the Ministry of Labor, Social Protection, and Family shows that in reforming pension system the equilibrium in the budget of Social Fund would be achieved in 2006 and would be positive till 2020. Calculations made by the WB experts shown the same findings and according to them the total sum of contributions could reach 50% of GDP in 2020 (in case of improvement in the administrative capability of the system).

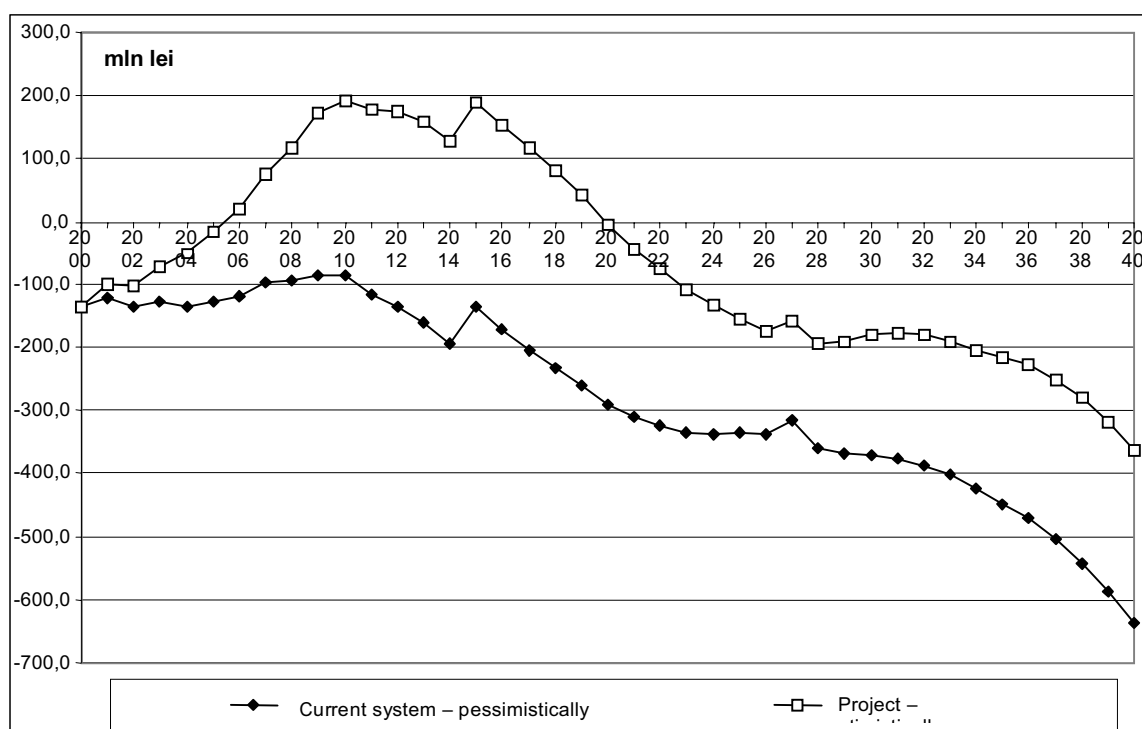
In promoting pension system reform it is critically important to introduce individual accounts in order to keep records on paid contributions. This would improve the ratio of

7. Pension system reform - first difficult steps

contribution collection, and at the same time would intensify the control and monitoring of expenditure distribution.

The program of reforming pension system envisages transition to new principles of social insurance while keeping rights received in the old system. Shifting to a new pension system should be a difficult process and some programs could last from 5 to 40 years. Thus increasing the retirement age will be implemented in 12 years, current pension payments will be eligible more 40 years, supplementing current PAYGO system with a three pillar – during 4 years.

Social Fund Budget (with and without reforms)



Shifting to a new pension system in Moldova encompasses several stages. At each stage the main strategic direction should be adjusted to the new economic and social environment. In this regard it is important to develop and improve a monitoring and forecasting system of pension development.

Besides that it must be taken into account that pension system is not a closed system, it represents a part of the economy texture. In this sense pension reform might not affect all macroeconomic indicators, although there could be some relations between them. First steps are always the most difficult in each enterprise but at the end they lead to a solution of so important issue as pension system is.

8. Economic reforms and conflict situations

The analysis of transformational processes in the countries in transition towards a market economy suggests that the majority of those processes are accompanied by conflict situations. This is quite easy to understand, because the *reform is a change, a progression from past to new*. Developed countries with well-established political parties and democratic societies experience fewer conflicts and at lower social costs. Countries like Poland, Czech Republic, Hungary and Slovenia already undergo progresses in the real sector, experience financial-budgetary stabilization. The state strictly determines its participation in the economy – as an initiator and promoter of reforms.

The success in those countries was attained through the timely creation of legal framework for the formation of the private sector as a guarantor of employment and solver of social problems. Next to the creation of a competitive private sector – the fundament for economic growth, these countries went through an increase in foreign trade. This brought an inflow of investments. It is important that in the processes of transformation of property and creation of new management forms the conflicts *did not generate destruction, but where a mobilizing force for the society*.

As for the post-Soviet countries, including Moldova, on one hand the sluggish and indecisive pace of reforms originated long-lived conflicts, and on the other hand, the social, *political and military conflicts blocked implementation of reforms*. The procrastination of reforms deepened the real sector degradation, unemployment problems and worsened the living standards. In some countries the pace of reforms was suppressed by lack of social consensus and continuity in the activity of the governments, succeeding in a row. Moldova, for example, had seven different governments between 1991 and 1998. In the absence of a medium-term development plan for the national economy, this fact delayed the pace and consequence of reforms.

Another important cause for the delay of reforms was the persistence in post-Soviet mentality of population, who expected the bulk of social benefits from the state. Simultaneously, the crisis in the production sector and tax arrears caused a chronic infringement of population needs by the state (social protection, full employment capacity, and salary arrears in the government sector.)

The absence of political stability and continuity in governmental actions in Moldova, the military struggle in Transnistria ruined the economic integrity of the country. Along with unrealistically overestimated expectations of population this has been dragging the reforms. Only in 1997 Moldova managed to put an end to its economic stagnation, to register a 1.3-percent growth of the Gross Domestic Product and to lower its inflation to 11.2 percent per year. The national currency remained relatively stable. But at the micro-level the situation has not been stabilized yet. Most enterprises operate at losses. Budget situation worsened as a result of huge internal and external debts.

In such conditions the success in improvement of the situation was temporary. Macro-instability and state budget crisis are delaying structural reforms, private sector development and the degree of labor force employment, leading to the development of a social crisis.

The 2nd government of Ion Ciubuc (May 1998) outlined a new complex of actions for the accomplishment of privatization reforms, restructuring of agrarian, energetic and industrial sectors, of the financial-budgetary environment, infrastructure and social sphere. Nevertheless, the Russian financial turmoil (August 1998) as well as internal factors harshly deteriorated the socio-political situation in Moldova. This needed an elaboration of a system of anti-crisis measures and their consideration in the 1999 budget, etc..

It became clear now that only financial mechanisms by themselves, without the revival of the real sector of the economy, are not enough to improve the situation. The only way out of the crisis is through restructuring of industrial and agricultural enterprises based on new technologies and advanced management. Reorientation toward competing markets will improve country's trade balance, reduce the pressure on the budget, expand the employment, and ease state's social commitments.

According to preliminary estimations, about 300-500 million US dollars are necessary for complete restructuring and upgrading of Moldovan enterprises. The country does not have such funds. The solution would be a tight cooperation with European Union, Mediterranean and Black Sea basin countries in order to collaborate in implementing joint projects. At the same time it is vital to maintain the traditional advantages, resulting from cooperation with the CIS countries.

A range of transition countries encountered *political-ethnic problems*, besides the above mentioned social ones. They slow down the economic reform and draw away a significant portion of resources targeted towards an antihuman utilization. Such conflicts originated in Russian Federation, Caucasus and Balkans. Moldova was not an exception. These conflicts, as a rule, have a foreign support. Elimination of this kind of conflicts requires time, as well as joint efforts of different countries: a refusal of foreign support for separatist regimes, that are eager to obtain recognition from the subjects of international law; application of resolute sanctions towards the countries, which assist the separatism, etc.

Another type of conflicts, which arises in countries in transition to a market economy, are *territorial conflicts*, linked to the infrastructure (gas pipelines, energy complex, road-transportation). These conflicts emerge as a result of undetermined frontiers between countries and refusal to cooperate for the improvement of the general situation. Among these conflicts, one of the most alarming cases for the Republic of Moldova are the difficulties emerged at the construction of Giurgiulești terminal on Danube River.

A common platform for settling the conflicts in transition countries is the democratization of the society, economy, and of the state. Democrat□□ states, in their essence, are not aggressive in their internal and external policies. They protect personality inviolability and property rights. A democratic society seeks for a compromise between the interests of all and each member of the society. This should be the objective of state's, economy's, and society's transformation in Moldova.

9. Public opinion: hopes and realities of the reforms

Transition towards a market economy, the economic reforms and radical social changes that have been taking place in Moldova since the early 1990th had a positive support from the community, that hoped to see good results in short time.

Unfortunately, those fundamental changes and transformations effectuated sporadically, as well as their further evolution changed the vector of feelings from initial hope to total desperation and deception. This phenomenon affected essentially the entire post-Soviet environment, including the Republic of Moldova.

In these regards, it is clear that any radical reform requires acceptance from population, because people are the main beneficiaries of reforms undertaken for the prosperity of the country. Unfortunately, the latter has not been reached. Political, cultural, as well as social sphere achievements are quite modest, while the future prospects for development of the society are quite obscure. In spite of the fact that some new positive phenomena had appeared, general consequences of changes and reforms that occurred so far are appreciated as negative, according to public opinion pools. Economic crises, Transnistria conflict, corruption, massive lay-offs, pension and salary arrears, massive poverty and many other cataclysms became attributes of everyday life.

Generally, the dynamics of public opinion polls initiated by the Independent Service for Sociology and Information (SISI) "Opinia" since 1991 show the existence and maintenance of a permanent tension in the society, induced by the adverse results of reforms. Thus, the share of population, defining the current situation in Moldova as *favorable*, does not exceed ten percent, while the share of those considering it as *critical* is between 80 and 90 percent.

According to the monitoring study "The Results of 1997" 58 percent of questioned population consider the direction of economic development to be *improper*, and only 31 percent consider it as *correct*. As regards to the social sphere, almost 60 percent of participants in public opinion polls have a negative attitude towards the reforms conceived here. It is worth mentioning that the dynamics of public opinion with respect to the discussed problems has been virtually unchanged lately.

High economic cost of reforms and the drop in living standards bring about protests and indignation of population. Consequently, the share of supporters of transition towards the market economy declined by 10 percent in 1998 compared to 1996, according to SISI "Opinia", and constitutes only 42 percent of country's population. In the same time, only 11 percent of population agree that Central Government has a well thought program of action, oriented towards the revival of economy and of the social sphere.

Recent studies of SISI "Opinia" show as the main concerns of population the following: inflation, poverty (77-87%), salary and pension arrears (66-73%), chaos and anarchy, lack of discipline and order at all levels of power (48-68%), corruption, criminality, and massive fraud (45-54%), economic crisis and fall in production (40-50%), unemployment (37-47%), and also country's future (33-39%).

The poll dynamics also reveals a strong stratification of population according to their living standards. The share of socially vulnerable population (at the survival level) increased from 20 percent in 1993 to 34 percent in 1998.

The problems mostly affecting the society and the entire community lead to continuous tension in day by day life, discontent about the life. At present virtually 2/3 of citizens (10 percent more than in 1992) have a miserable life, almost 20 percent are below poverty level, and only 10 percent are satisfied with their present life.

Consequently, over half of Republic's population considers it impossible to tolerate any

further the indigence they suffer. The share of population uncertain of tomorrow is quite stable - 80 percent of total citizens.

Comparative sociological studies (dynamics of opinions) in 1992-98 reveal the persistence of apathy and indifference (40-55%), resentment (46-54%), fear (26-39%), cruelty and aggressiveness (21-33%). The feelings of dignity (3-9%), confidence in the future (3-18%), and pride for the country and people (3-13%) have become secondary now.

In spite of society's democratization process, the polls are continuously showing a pronounced detachment of governing institutes from people's needs, problems and interests. Thus, people's dissatisfaction by the level of democracy in our society and by the quality of public administration constitutes 81-83 percent. For several years (1994-98) 80-87 percent of country's population consider that decision-making on vital issues for the Republic of Moldova is made without any consultations with people.

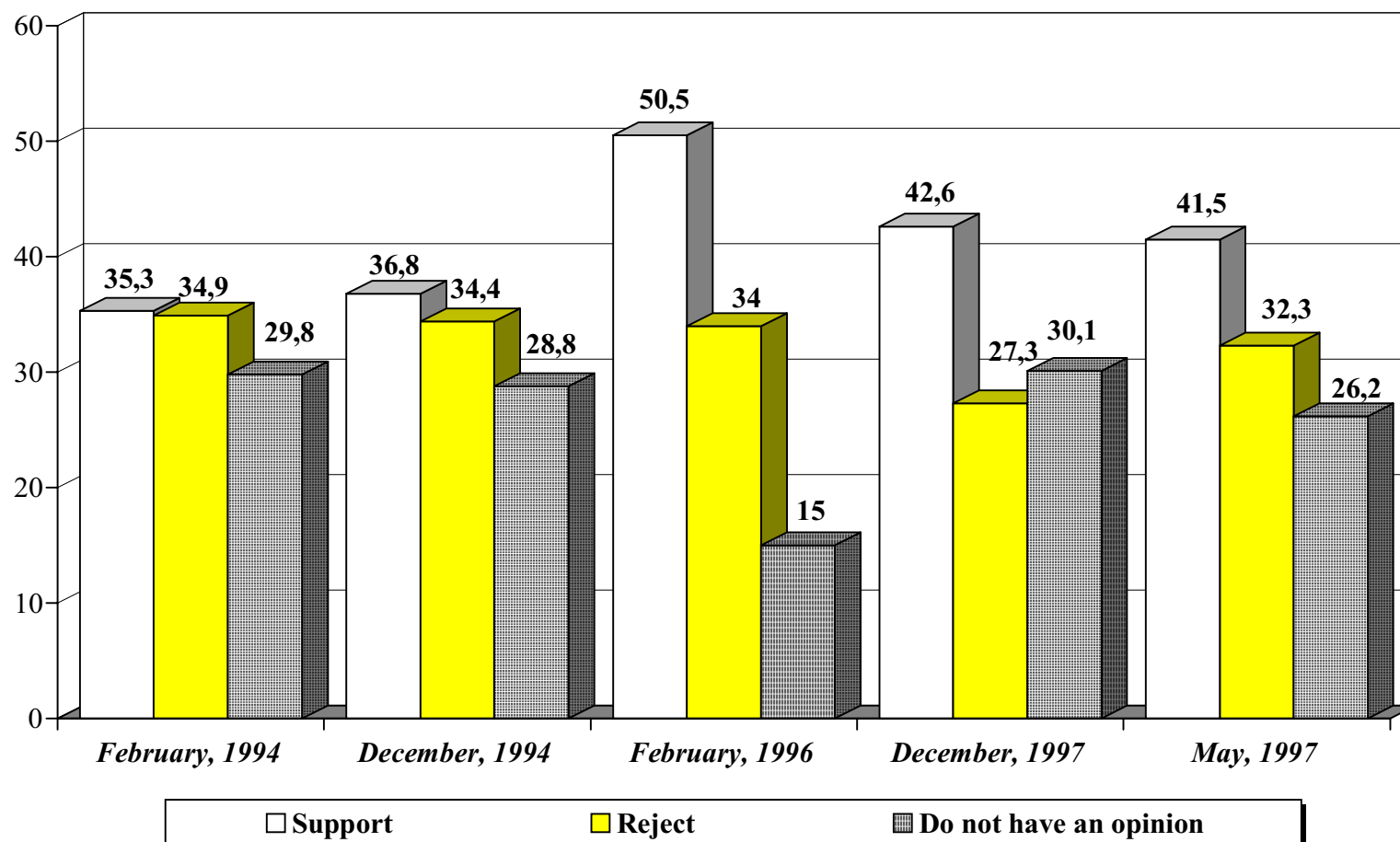
Conclusions:

- Changes taking place in our society in the last few years have a rather negative than positive effect, according to public opinion polls;
- The degree of citizen's information and familiarization with reforms occurring in the country is very low; consolidation between state and personality in the process of social changes is weak;
- The degree of population's lack of faith in the course and outcomes of reforms increases its disbelief;
- A process of amplification of resentments occurring in the society, leads to tensions;
- People are looking with pessimism into the future of the country, to the possibilities of improvement;
- The dynamics of opinion polls exhibits an increasing dissatisfaction of residents with the level of democracy, with the total ignorance towards public opinion from the governing bodies in regard to changes and social processes in the Republic Moldova.

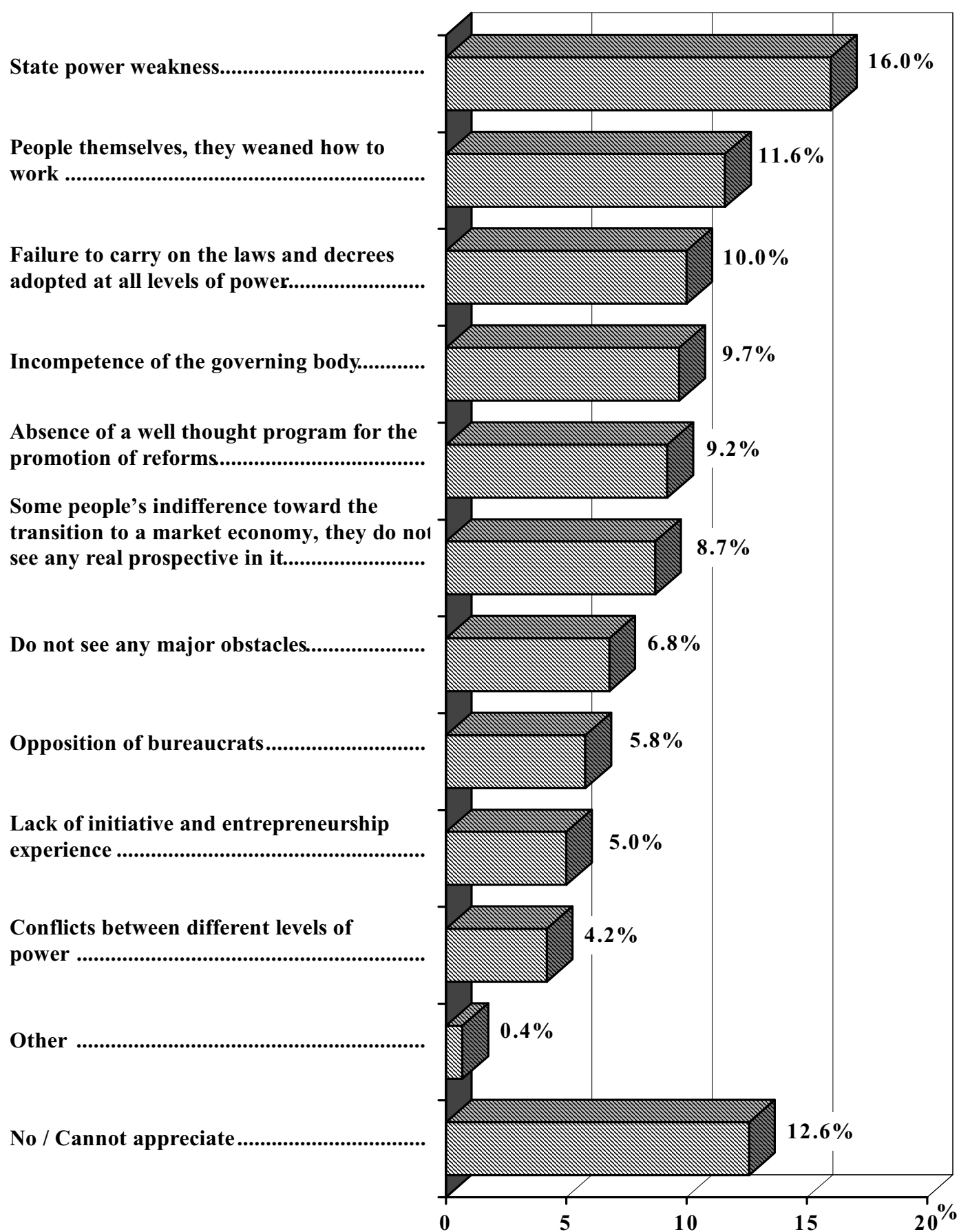
Recommendations:

- Any social change is going to fail if it is not deeply understood and accepted by community. The actual reform process requires a profound public familiarization and information with the development strategies of the country, its prospective and implementation process;
- The most vulnerable demand a special attention from the state: unemployed citizens, young people, the intellectuality – country's cultural and scientific potential. Correct, well-thought and efficient programs must be an imperative;
- Empirical results show that the public opinion plays a very important role in social-economical development. Unfortunately, the public opinion results are consulted only during election campaigns, a permanent research of different aspects of actual realities being completely ignored.

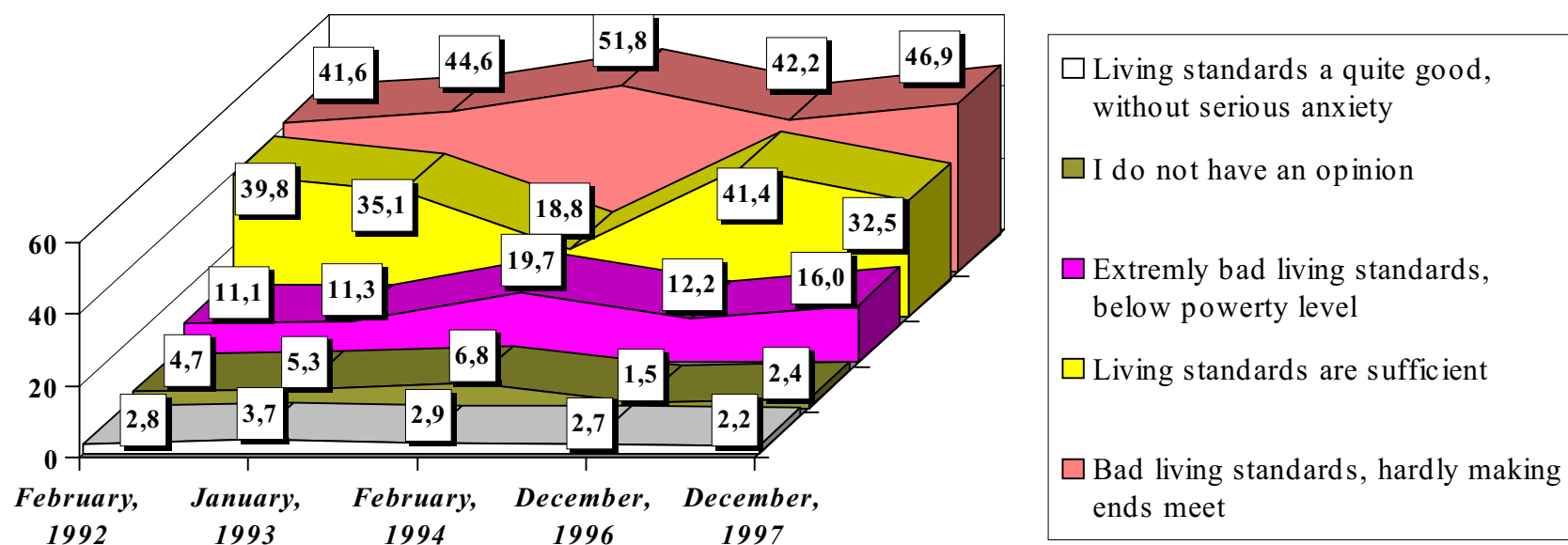
The governing bodies, other social institutes should permanently base their activity on public opinion, should permanently keep the hand of the pulse, evaluating correctly the reaction of public opinion to all changes in the society.

Moldovan population attitude towards the transition to a market economy

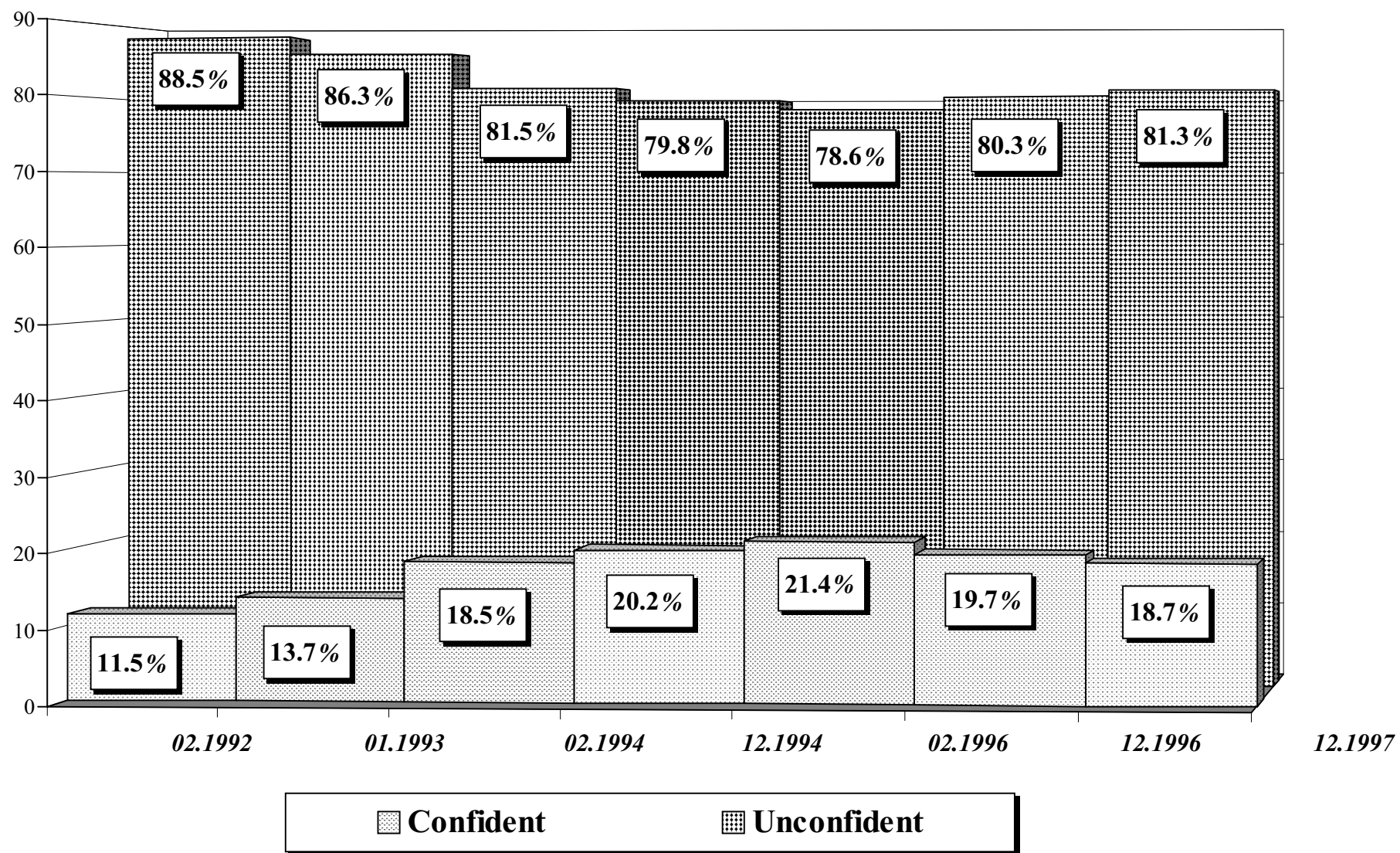
Which is the main obstacle in the course of reforms, in your opinion?



Living standards of Republic of Moldova's population



Population confidence in the future



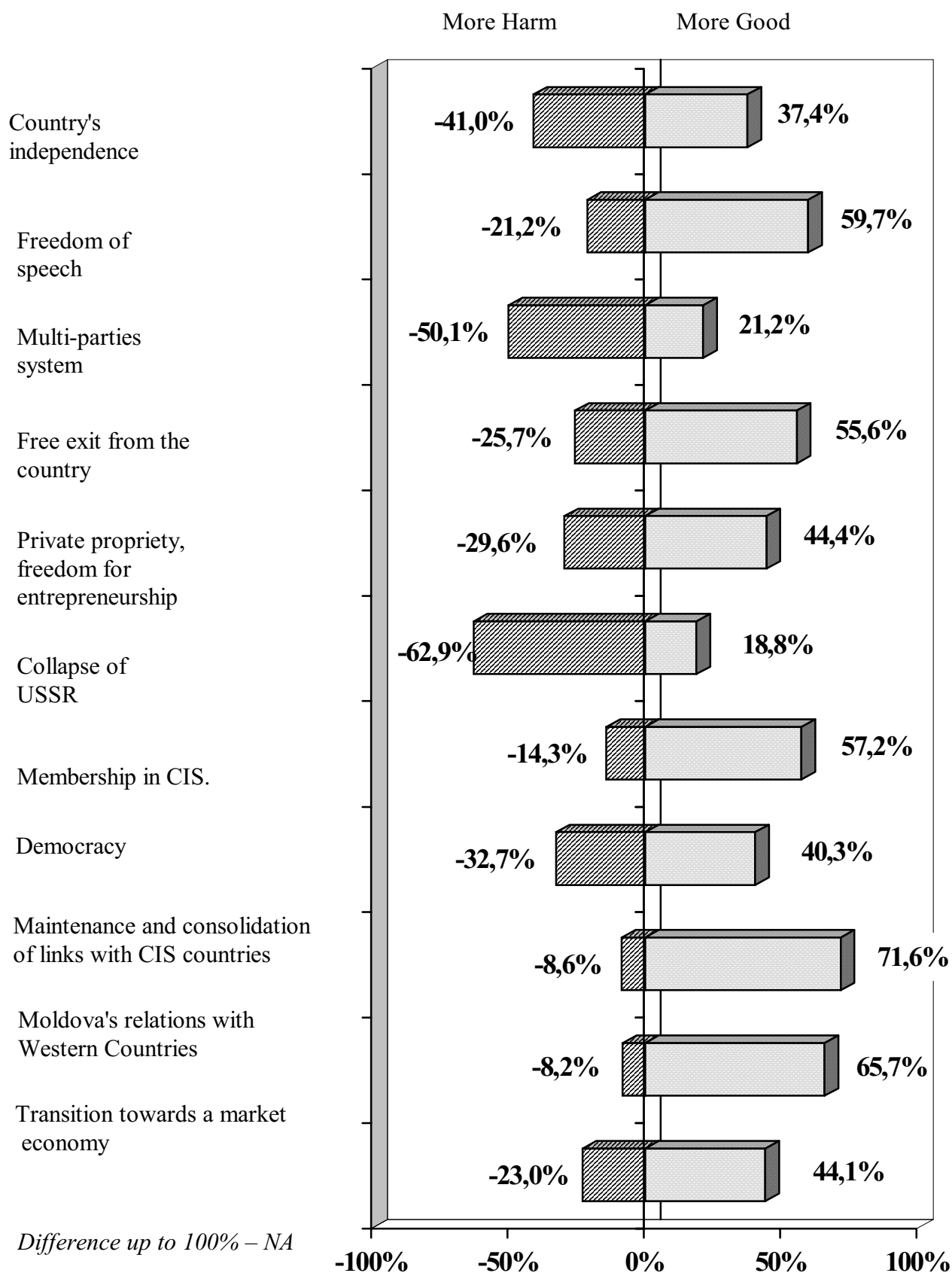
Problems of the society that make population worry the most

	<i>02.1994</i> %	<i>02.1996</i> %	<i>12.1996</i> %	<i>12.1997</i> %
1. Increase in price level, inflation, worsening of living standards, poverty	86.9	75.6	78.4	77.1
2. Salary and pension arrears	***	66.0	70.2	73.0
3. Chaos and anarchy, lack of discipline and order at all the levels of power	68.7	51.4	58.5	48.1
4. Corruption, outburst of mafia and criminality, massive fraud	51.3	48.4	45.3	45.9
5. Expectations towards of the future of country and population	***	37.0	33.3	39.2
5. Unemployment	***	42.3	42.3	36.9
6. Economic crisis, production drop, insufficient management skills	49.8	38.3	41.0	33.9
7. Social protection and equity, lack of state support for people needs and problems	27.9	25.6	23.2	21.0
8. Lost of interest for a honest way of work and production	***	***	20.9	18.0
9. Destruction of the environment	15.3	20.9	7.2	14.9
10. Crisis of morality, culture, spirituality, inter-human tension	25.0	15.5	10.4	14.8
11. State power's weakness, incompetence and impotence	37.5	21.4	10.1	14.4
12. Conflicts and intrigues, lack of coordination between branches of power	***	***	9.3	7.5
13. Interethnic extremism and separatism, Republic's disintegration	26.2	***	5.0	5.2
14. Other problems	0.2	0.2	0.1	0.4

*** – These indicators were not studied

Changes occurred in Moldova in recent years and their consequences, according to public opinion polls

Which of the following changes brought more good or more harm for the Republic, in your opinion?



10. Interference: political background of reforms

The starting point

The fabulous changes that the ex-soviet countries have gone through after the early 90's, have proven a close dependence between the economic and political processes. In the Republic of Moldova the political confrontations often left a profound negative footprint upon the process of economic reforms. The crisis from late 1998 constitutes only a logical sequence of the long run period, when the economic reform in Moldova has been the hostage of political realities. Let us make a closer look at the years under review.

The policy of democratization and "perestroika" launched by Gorbachov in 1985, had negative consequences for the initiator himself. The former Soviet Union republics took seriously the fact, that according to USSR constitution, they were entitled to be considered sovereign states. The Baltic States were the first to consciously start the process of secession from the Soviet Union and to transform into states recognized on international arena. As driving forces of those processes were the new political forces called "Popular Fronts". With some delay, similar processes ran also in the Soviet Socialist Republic of Moldova (SSRM). After the famous for that time Article 6 from the Constitution of the USSR was canceled, which stipulated the monopoly of the Communist Party, the process of political pluralism, structuring in form of "public movements" also started in Moldova. In October 1989 in Chişinău four new political formations were registered: Popular Front of Moldova, Internationalist Movement "Edinstvo" ("Unity"), the movement "Gagauz Halkı" ("Gagauz people") and the "Vozrozhdenie" ("Revival") movement. With some insignificant exceptions, all these formations were set up based on ethnic criterion. This reflected the profound split up of the Moldovan society as a result of the confrontations from 1988-89 *vis-a-vis* the problems that only apparently seemed to be of linguistic nature. The substratum was much more profound. The society split into those who wished to preserve the political system and old system of economic relations in the society, and those who felt the possibility to change the society. The elections ceased to be a boring procedure with predetermined results by the Communist Party decision makers. In the spring of 1989 the first elections were held when many more candidates per one circumscription were admitted, for the Supreme Soviet of the USSR. The confrontations upon the linguistic issues transformed into a struggle for political power. The initiative was resumed by the Popular Front, whereas the Communist Party of Moldova, since the summer of 1989, lost the control on the situation. Through that all, the situation was rather confused because many activists of the new political formations, including of the Popular Front, continued to be formal members of the Communist Party. The struggle for officialization of the language of the native population, reintroduction of the Latin alphabet and recognition of its identity with the Romanian language deeply shattered the political system, imposed on the right bank of the river Nistru after the formation of the SSRM in 1940. In the summer of 1989 large masses of the population engaged in political confrontations.

The turbulent political processes from 1988-1989 disclosed the availability of a strong political contrast in the republic. The demarcation line was running along the bank of the river Nistru and included the town of Bender. The specific trait of this zone, which subsequently was named Transnistria, was mostly conditioned by the policy promoted by USSR center for many decades. On that part enterprises were focused, that were subordinated to the Union center and were part of the military industrial complex of the USSR accounting for about 20% of the entire industrial potential of Moldova. Also, in that zone for many decades troops of the 14th army

have been deployed, whose veterans preferred after retirement to reside there. These two factors impacted profoundly the dominated spirits of the population and essentially changed the ethnic composition and mentality as compared with the right bank of the river. Most of the population from the industrial centers of Transnistria stood categorically both against the national revival of the autochthons, and against the idea of transforming the SSRM into an independent state. The situation was aggravating also due to the fact, that the Transnistrian population at that time (1988-1989) was able to obtain the information of the political processes going on in Chişinău only from Russian language press, fully controlled by the Communist Party, which, while loosing the political initiative, interpreted everything that was taking place against its will as manifestations of aggressive “Romanian nationalism”, as a prelude of an overnight unification of SSRM with Romania. As a result, from the very beginning, the trust between representatives of those two banks was missing. On the left bank the political initiative was taken by the extremist political formation “OSTK” (“The Unified Council of Labor Collectives”). If on the right bank the initial Popular Front emerged as an antipode of the Communist Party, then on the left bank the “OSTK” emerged as a tougher promoter of the “Soviet” ideology, shaped into a mostly extremist form.

At the same time, there is a common parameter for the participants of the political confrontations in Moldova – the low level of political culture, totalitarian mentality and primitive perception of the complexity of the problems the society faced. This was particularly noticed in economic aspect. Both new leaders and the population were extremely sensitive to everything that was related in a way or other to the national aspect, regardless of the economic future of Moldova. Unfortunately, today in Moldova there is not at least one sound and influent school of economics that would have been able to impose itself in front of the politicians as an authority in the economic field.

The economy of the Soviet Socialist Republic of Moldova from the very beginning was constituted as a component part of the economic complex of the Soviet Union. The industrial sector, as well as the agrarian one, was fully integrated within USSR. About 90% of the trade was made with the rest of the USSR. In Moldova there was a relatively well developed agro-industrial sector (compared with the overall development level in the USSR).

Starting with the elections from 1990, there were held already five electoral campaigns (1991; 1996-presidential; 1990;1994;1998 – parliamentary) in Moldova. The results of these elections have strongly influenced reforms in the society, and particularly economic ones. At the same time, their results reflected both changes of the expectations of population during those years, as well as its reaction to consequences of the governance elected ruling forces. In this aspect, it is important to make an analysis of these two parameters.

Elections from 1990 ran based on the majority principle in 380 Union level circumscriptions. The excessively big number of circumscriptions was imposed by the leadership of the Communist Party of Moldova, which considered that the Popular Front will not have enough forces to cover by its candidates such a big number of circumscriptions. None of the political forces announced its list of candidates during the electoral campaign. As mentioned above, the situation was very confused, because members of the Communist Party were claiming on behalf of all newly formed political formations. This made the Communist Party of Moldova to announce its electoral victory, because 83% of all the new deputies at the moment of elections were formally its members. However, in reality, almost 120 mandates were obtained by the Popular Front; approximately the same number by the representatives of the agrarian sector, elected through the circumscriptions from the right bank; 64 deputies were elected in circumscriptions from the Eastern raions of the Republic of

Moldova, all of them being “blessed” by OSTK.

First experience of parliamentarism

The activity of the first parliament went through several more stages. It was considerably marked by enthusiasm and romanticism. In conditions of society's first steps towards democratization, the role of member of parliament (MP) was totally new for the elected. The newly emerged political elite of Moldova tried to learn *ad hoc* what means to govern a state. It is enough to mention, that the candidacy of Mircea Druc, the representative of the Popular Front, as the prime-minister, was supported in the Parliament almost unanimously. *De facto*, in the Parliament a national non-formalized bloc was constituted, comprising the representatives of the Popular Front and managers of the agrarian farms, elected though the circumscriptions on the right bank of Nistru. Jointly they constituted a majority of more than 2/3 who voted the Declaration on Sovereignty on June 23, 1990, approved the coat of arms, the state banner, etc. Yet, the romantic phase lasted less than a year. In the Parliament a regrouping of forces occurred. Political situation in Moldova aggravated promptly, the secessionism in the Southern and Eastern parts of Moldova got beyond control of the central power. On August 19, 1990 in Comrat the *Soviet Socialist Republic of Gagauzia in the composition of the Soviet Union* was proclaimed, and respectively, on September 2, in Parcani – the *Transnistrian Soviet Socialist Republic of Moldova in the composition of the USSR*. Profiting by the political mistakes of the new leaders of Moldova, the USSR center succeeded to use the secessionism in Moldova, in comparison with Baltic States, as an instrument of blackmail aimed at maintaining the republic in the USSR. The behavior of the prime-minister Mircea Druc showed that the Popular Front proved to be unprepared for a real governing. The action program of the Government was a declarative document, based on certain romantic notions regarding the manner of market economy operations. The complexity was not comprehended of radical changes in the relations of ownership and there were no suggested mechanisms of economic transformation. Neither had been attempts to estimate the social costs. The categorically negative attitude towards USSR did not have as background any program of consolidation of economic independence of Moldova as a sovereign state. Instead, the Druc cabinet was easily involved in political confrontations in Moldova, ignoring the process of economic reforms. The so-called “volunteerada” from the summer of 1990, organized by the cabinet as an instrument of the Popular Front, events at the bridge-head in Dubasari from November, which led to loss of human lives, brought the existence of the national bloc in the Parliament to an end. Only after one year of activity as head of cabinet, Mircea Druc was dismissed, even with participation of some of his previous supporters. At that time the political initiative was resumed by the President of the Republic Mircea Snegur, under whose umbrella one more year acted the following cabinet headed by Valeriu Muravschi.

Testing by privatization

The privatization process of the state property constitutes a key element of the economic reform. The attitude towards that and manner of approach discloses both the level of competence of the reform promoters, as well as their real interests. In its turn, the success or failure of the privatization process can impact decisively the reforms run. Unfortunately, the reality showed, that none of the political forces from the Parliament elected in 1990, none of the MP groups had clear targets regarding a privatization model suitable for the economy of Moldova. Consequently, on July 4, 1991, the Parliament of Moldova rejected the draft law “On privatization”, suggested by its own cabinet, and adopted absolutely unexpectedly the version of the law, worked out and submitted only a couple of days before, by a group of

members of the Social-Democratic Party of Moldova, a party which was not represented in the Parliament and had nothing to do with the power structures.

The problem of land privatization provoked even harder confrontations in the Parliament between the representatives of the Popular Front and the “agrarians”. The latter, who regarded the collective farms as a mechanism of controlling the electorate and a sure source of personal enrichment were looking for various excuses to slow down to maximum the land privatization process (of breaking-up the collective farms). The Popular Front insisted categorically on the peasants’ right to land ownership. The Land Code, emerged as a result of confrontations between the main political forces of that time, was enforced on January 1, 1992. The Popular Front succeeded to get the formal right of the peasants to land ownership, whereas the Land Code stipulated no mechanism of a guaranteed enforcement of this right. Both of those two political forces, through which most of actual politicians started their careers, showed a level of competence in economics far below the requirements and were unable to work out a coherent program of transforming the agrarian sector of Moldova on the basis of market economy principles.

The genesis of the first ruling party

The events in the summer of 1991 running in Moscow did not leave Moldova any alternative, - on August 27, 1991 in an atmosphere of total enthusiasm the Parliament proclaimed the independence of a new state on the political map of Europe. The political elite of Moldova got face to face with a series of unprecedented problems. In short period of time they were supposed to erect the real structures of a real state.

The putsch in Moscow meant concomitantly the end of the Communist Party in the form previously imposed by Moscow. After the Communist Party was banned, the agrarian deputies, being confronted with the Popular Front and feeling the need of a political party to defend their own interests, in October 1991 set up the Agrarian Democratic Party of Moldova (ADPM). The “agrarians” after the “divorce” with the Popular Front became most influencing force in the Parliament, holding 118 mandates. At the same time, it is necessary to remark, that the ADPM, in comparison with the Popular Front, for instance, has never been a political party with a political platform fully shared by all its members. In reality, at the beginning they consolidated as former members of the vanished communist party with a goal to promote certain corporate interests linked with the old manner of organizing the agrarian sector.

The armed conflict in the spring of 1992, the Bender tragedy from June 18, 1992 determined a totally new correlation of forces in the Parliament. Andrei Sangheli’s appointment as prime-minister meant *de facto* installation of the ADPM to power and the end of domination of the Popular Front both in the Parliament and the society as a whole. In formal terms, this political formation’s governance (ADPM’s), lasted almost 6 years and ended up on March 22, 1998 when this party did not gain even 4% at the Parliament elections. At the same time, the formal governing of one and the same political power did not mean conservation of political processes in the society. In this sense it is important to compare the results of the parliament elections from 1994 and 1998 and to analyze the interdependence of the political processes with the economic ones.

Evolution of the political spectrum

The elections from February 27, 1994 were the first elections based on multi-party system. Also, for the first time they were held according to proportional principle. The whole

Moldova has been declared as one circumscription, and each electoral competitor presented a list of candidates. For participating in sharing the places in parliament it was necessary to pass a 4% threshold. The comparison of the 1994 and 1998 elections is simplified by the fact, that the “rules of game” remained unchanged (except for some small details). The results of every poll are appreciated usually after the distribution of mandates in the parliament. At the same time, it is necessary to mention, that due to the 4% threshold at the poll from February 27, 1994 more than 23%(!) of valid votes were lost; on March 22, 1998 – more than 18%. This is why, in order to provide the correctness of the analysis it is necessary to take into account not only the distribution of mandates in the Parliament, but also the political preferences of the electorate who voted for the electoral competitors which remained under the 4% threshold.

The first conclusion possible to be drawn from the diagram below is that already in 1994 more than 16% of the voters who participated in the elections were looking for an alternative to either the Moldovan “leftists” or “rightists”. In other conditions, this “center” would have been represented by 16 mandates of MPs, which might have meant a totally different correlation of forces in the parliament. ADPM wouldn’t have held an absolute majority in the Parliament, and even the first experience of elections based on multi-party system might have obliged the Moldovan politicians to create a coalition cabinet. In reality, however, the ADPM won 56 mandates of the 104, which allowed to create a “monocolor” cabinet headed by the same Andrei Sangheli. The poll on March 22, 1998 showed that the number of those who looked for an alternative to “centrists” during four years increased two fold, this time accounting for 33.56%. Now the “center” is represented in the Parliament by the Bloc for a Democratic and Prosperous Moldova (BDPM) which won 18.1% and, respectively 24 mandates. Nevertheless, at this time about 16% of votes in the “center” were lost.

The parliamentary elections from 1994 took place at the time, when Moldova undertook the first steps towards market economy. The privatization process was already unleashed. In 1992, in conditions of extremely sharp crisis provoked by the Transnistrian conflict, Moldova started the collaboration with the international financial institutions. In the fall of 1993, only some months before the first parliamentary elections in conditions of statehood independence of Moldova, the Moldovan leu was introduced into circulation. Subsequently, at that poll the Moldovan voters decided what political force assigned to implement the economic reform, will lay the cornerstone for setting up the economic foundation of the new state.

Evolution of the ruling party

Emergenced in October 1991 based on the “Viata Satului” (“Countryside Life”) club, the ADPM already had consolidated its forces for the first elections based on multi-party system in some more aspects. In organizational aspect, it comprised an area of almost 600 collective farms which were treated by the “agrarians” as primary organizations. In the situation, when the rural population was very poorly informed about the essence of the processes in Moldova, this fact constituted an extremely efficient mechanism of forming the electoral option in the countryside. Andrei Sangheli, the informal leader of the ADPM, already in 1994 had been being prime-minister for two years. On ADPM’s candidates list was also included the that time Chairman of the Parliament Petru Lucinschi, whereas Mircea Snegur as President of the Republic openly supported this political formation. Thus, the majority of executive power structures, either openly or latently, got involved in the electoral campaign on behalf of the ADPM. took

The electoral message of the ADPM was as simple as possible. On the background of Popular Front radicalization and after the bloody conflict in 1992 which shocked the majority of the population, the ADPM succeeded to impose itself in the opinion of many people as an acceptable alternative to the political extremism, as a warrant of statehood (in the sense of non-unification with Romania), preserving the traditional economic relations (with CIS), etc. At the same time, a considerable part of the Moldovan electorate was already affected by nostalgic sentiments and negative attitude towards such notions as “market economy”, “democracy”. The electorate was not concerned of the fact that in the candidates list of this party were included people of various formations, obviously fortuitous, and by the perfunctory nature of the pre-electoral platform. ADPM won a categorical electoral success. Having 43% of votes and 56 mandates in the Parliament, out of 104 places, ADPM became a ruling party. After the victory of the ADPM Mircea Snegur, being the President of Moldova elected through general poll (Dec. 8, 1991), declared himself member of this party.

ADPM formally survived as ruling party for four years. Yet, in reality it was not able to fulfill its role of ruling party. The need to promote real changes in the society evidenced the fact, that the ADPM members had political views, let alone personal interests, which were often incompatible. Being on a list of candidates for the sake of access to power, they were not able to run their activities based on a common program of governing. Already after one year 11 “agrarian” MPs headed by Nicolae Andronic left the ADPM faction, accusing the former party fellows of lack of real reformism. The President of Moldova Mircea Snegur categorically distanced from ADPM, and in an year joined in a direct disagreement with them.

The illusion of ADPM’s existence as stable political party was dissipated by the electoral competition in 1996, when three “agrarians-94”, Mircea Snegur, Petru Lucinschi and Andrei Sangheli engaged in a competition for the position of the President. Despite the fact, that the congress supported Andrei Sangheli as candidate, it was obvious that the ADPM members dispersed around at least four candidates: Sangheli, Lucinschi, Snegur and Voronin. The obvious failure of the ADPM candidate Andrei Sangheli as claimant for presidency led the ADPM’s political domination to an end. Mr. Andrei Sangheli retired from prime-minister. In those conditions the preservation of parliament elected in 1994 was conditioned more of the desire of the deputies to maintain as long as possible their positions. The political initiative was resumed by Petru Lucinschi, the new President of the Republic of Moldova. The new prime-minister, Ion Ciubuc, was promoted not as a representative of the parliamentary majority, but as the “representative of the President”.

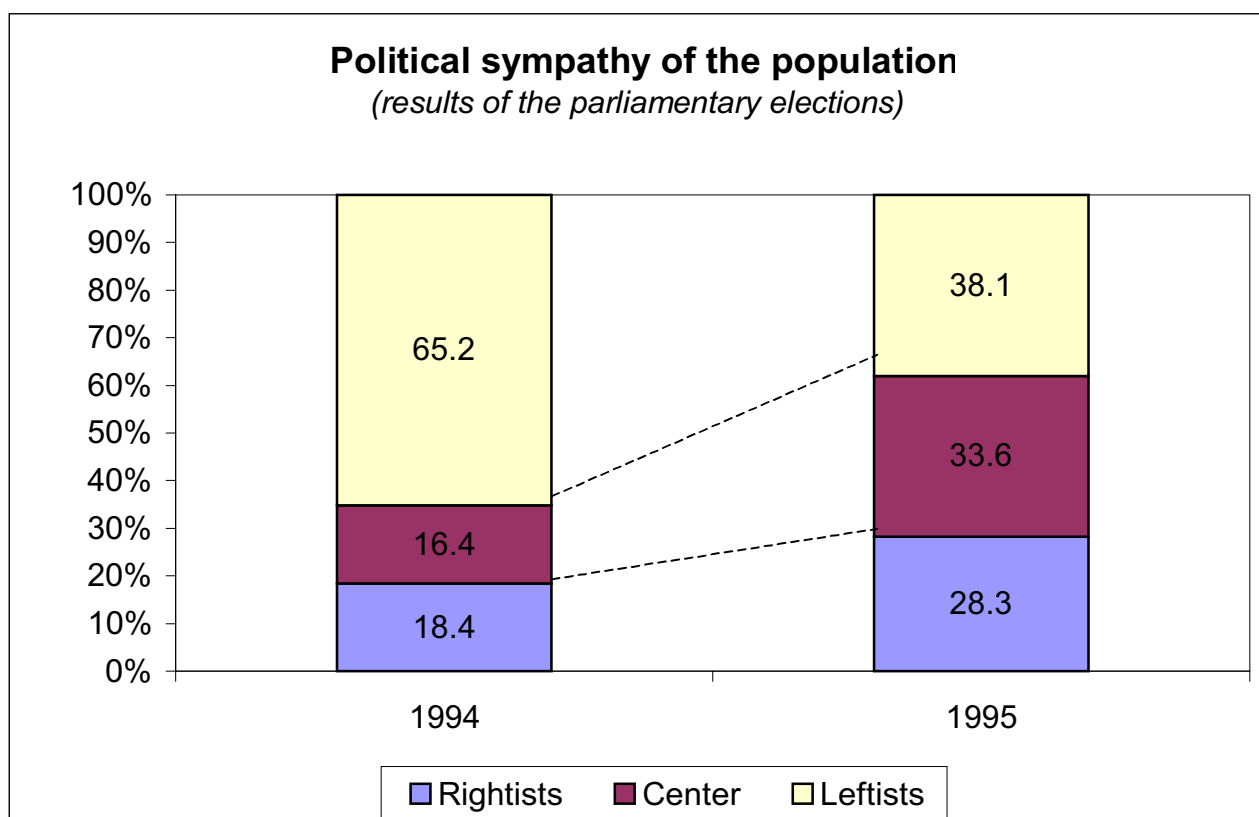
The parliamentary elections from March 22, 1998 meant a political end of ADPM. The former “agrarians” were included as candidates of many electoral competitors, starting from Democratic Convention of Moldova, considered as a right political force, to the Party of Communists of Moldova. The 1994 ADPM’s electorate was taken over mostly by the Party of Communists and the Bloc for a Democratic and Prosperous Moldova, which was associated with the expectations of the voters related to Petru Lucinschi, the new President of Moldova. The ADPM, which was in power for 6 years obtained during the poll of March 22 only 3.63%, which did not make possible its representation in the Parliament. After the Parliament elections from March 22, 1998 a new correlation of forces was created. The center-right governing coalition was constituted. The former leaders of opposition got the possibility to participate in the government of the country, to demonstrate the superiority *vis-à-vis* the “agrarian-interfrontist” governing.

The economic reform and Moldovan reality

The application of market economy principles in the Republic of Moldova had as purpose the creation of conditions for shifting from command administrative system of economy management to liberalized economy. The background of this process was the radical changing of ownership, - from state owned property to private ownership both in the industrial sector, as well as in the agrarian one. The change of ownership relations implies radical changes of the structure of the national economy, - the economic agents who are not able to adapt to market economy conditions being supposed to disappear. The national currency, low rate of inflation, transparent legislation and the encouraging fiscal policy should create a favorable climate for investments in the national economy. The IMF, WB, EBRD, each one in its field, should grant assistance while the national economy goes through the difficult restructuring period. From political viewpoint, this economic reform scenario would have been proper to be promoted by a political party based on a consequent liberal doctrine. Only in that case the period of the reform would have been minimal, and respectively, the social cost minimized.

The notions of “market economy”, “restructuring” imply essential changes in any country. Yet, in case of Moldova they equaled to truly dramatic changes for its citizens. These words mean that its economic potential which constituted only a part of the economic body of the ex-USSR, engages to compete equally with other states on the world market. The shattering contrast between what the economy of Moldova was within the composition of the former USSR, and what should Moldova economy become as independent state, means, first of all, new requirements towards the employees of the national economy. Overwhelming majority of the Moldovan population turned to be unprepared in terms of psychological and professional aspects. For instance, the privatization in the agrarian sector for Moldova means emergence of some 2 million land owners. Yet, it is absolutely clear, that of those who have been “collective farmers” for a whole life, only very few will be able to adapt to newly emerged rules of the game. At the same time, the electoral realities of Moldova showed, that the number of citizens who are conscious of the processes’ irreversibility and are not affected by the nostalgic feelings, is relatively small. Thus, in conditions of regulated elections, the “nostalgics” had all the chances to vote correspondingly, both in 1994, as well as in 1998.

The “democracy” and “market economy” related slogans were stated as early as at the 1990 elections. Yet, the realities that followed (political crisis that generated the armed conflict, obvious decline of the living standards, etc.) led those slogans to compromise according to the views of many people. The society was not able to perceive, that it does not suffer due to “democracy”, but due to incompetence of those who engaged in its promotion. Thus, in 1994 the vote of the “nostalgics” (see the Chart) brought to power a party which *de facto* constituted a segment of the former communist party.



1994

“Right”

Alliance of the Christian Democratic Popular Front
 Association of Victims of Totalitary Regime
 Block of Peasants and Intellectuals
 Ecologic Party “Green Alliance”
 National Christian Party

“Center”

Social-Democratic Block
 Democrat Party
 Women Association
 Republican Party
 Democratic Party of Labor
 Party of Reforms
 Independent candidates

“Left”

Agrarian Democratic Party
 Block of Socialist Party and “Edinstvo” Movement

1998

“Right”

Block “Democratic Convention”
 Party of Democratic Forces
 Christian Democratic Union

“Center”

Social-Democratic Party
 Social-Democratic Block “Speranta”
 Block Civic Alliance “Furnica”
 Block “For a Democratic and Prosperous Moldova”
 Block “Alliance of Democratic Forces”
 Independent candidates
 Party of Reforms
 United Labor Party

“Left”

Party of Communists
 Agrarian Democratic Party
 Party of Economic and Social Equity
 Block “Socialist Union”

But the situation of the Republic of Moldova as independent state, the vigorous start of economic reforms in Russia did not let the governing officials of Moldova, as in the case of independence declaration, not a single chance. Regardless to political color they had to follow the way of economic reforms.

Formation of a monocolor Cabinet and the comfortable majority in the Parliament allowed the “agrarians” to manifest themselves freely as ruling party. Most obviously showed their level of competence in the agrarian sector. On the one hand, as early as of January 1, 1992 the Land Code was enforced, which theoretically stipulated the possibility of the peasants to become land owners. On the other hand, particularly in the territory, the “agrarians” were creating impediments in the process of land appropriation though all possible ways, being aware about the real position of the ADPM in this regard. Moreover, on November 8, 1994 the ADPM faction through its decision ceased the privatization of land by peasants. It was necessary for the opposition to appeal to the Constitutional Court for its cancellation. The total “barterization” of the economic relations in the agrarian sector created a favorable environment for theft and corruption. The ADPM faction was not capable to provide for a diversification of export markets for Moldovan products. Universal orientation towards the Russian market engendered “contamination” of the Moldovan economic system with mostly harmful vices. “Double accounting” became a normal experience in the relations among economic agents, for the society at large. ADPM, starting from the corporate interests of its leaders, tried to save the socialist variant of the Moldovan agriculture through burdening the industrial sector. Preferential tariffs for the economic agents of the agrarian sector for purchasing energy resources, all types of subsidies from the state budget, writing off the arrears to the budget, etc., became a normal tool. Till the end of its ruling period ADPM did not have any program of transforming the Moldovan agriculture into a competitive and viable sector of the national economy. ADPM did not understand, or it did not endeavor to admit in front of its electorate, that Moldova has no chances to become a prosperous state as an agrarian country. Consequently, after this “reformatory” policy, the industrial potential in Moldova degraded, neither the agrarian was rescued. In the society corruption emerged, the shadow economy got beyond control. Ignorance of the fundamental problems led to extremely problematic results in the energy sector. Blockage of reforms in this strategic field for any state, the erroneous tariff policy, massive defaults and theft of energy led to its degradation in terms of technical state, created a vicious circle of mutual arrears that as of today can be broken only at huge cost for the society.

The conflict in the spring-summer of 1992 on the Nistru led to dismantling of the integration of the economic complex of Moldova. Six years passed since the military confrontations were ceased. Unfortunately, during this time no political progress has been reached in resolving the conflict. Instead, this zone became a “free zone” for smuggling cigarettes, oil products, illegal trade of guns, etc. The state, unfortunately, shows neither political will, nor competence for ceasing the contraband. Many people consider, that the losses for the Moldovan budget due to non-resolution of the Transnistrian problem are much higher than the coveted loans from the international financial organizations.

The economy and electoral “non-stop”

A contrasting element on the background of the process of the national economy degradation constituted the “behavior” of the Moldovan leu. Thanks to the policy promoted by the National Bank of Moldova, stability of the national currency was assured during almost 5 years. In Moldova emerged its own banking system. But it turned out that this was not sufficient to rehabilitate the economy. The sharp decline of GDP in the national economy in 1995 was practically stopped. According to monetarist canons the process of economy

reanimation should have started. Yet, the recent years showed, that there is one more factor which affects far too negatively the situation of the national economy. These are the “apocalyptic expectations” of the society on the eve of elections and usage of the state structures as electoral teams. The first factor each time provokes “money laundering” from the national economy, the other – each time leads to paralyzing the state power structures. If in 1994 the ADPM was regarded by everybody as a ruling party, and the interests of the President, Chairman of the Parliament and prime-minister were pertaining to it, then in 1996 the same three leaders were involved in the electoral campaign, using the state office holders in their electoral teams according to personal fidelity criteria. At the parliamentary elections in 1998 the members of the cabinet were included as candidates on the lists of some electoral competitors. In two years the state did not have a Cabinet capable to act as a consolidated team committed on a program of national economy reformation, applying consequently the principles of the monetarist policy.

The elections of 22nd of March 1998 only aggravated the situation in this regard. Formation of the new Cabinet in conformity with the “algorithm”, but headed by a prime-minister suggested by the President, did not lead to establishment of a competent and efficient team in reforms promotion. Without such a team, any reform, particularly an economic one, runs into a chaos. The financial crisis from the Russian Federation just accelerated the negative trends in the Moldovan economy, which became irreversible two years ago.

Findings

One of conclusions that can be made is, that Moldova needs to make changes in the Constitution. Experience of many other countries which have gone through painful reforms showed that the economic growth cannot be ensured without a political stability. The non-criminal private capital is less sensitive at the firms which are drivers of economic transformations, but which categorically avoid the zones of political instability. The example of Chile is significant in this regard. Without rejecting the principle of power separation, Moldova still has to choose, - either it renounces the presidential institution and the parliament majority assumes the entire responsibility, without complaining that President admits impediments, or the President, elected based on general vote provides for the stability of the executive power in the country for at least four years. What can afford Italy, changing the cabinets year by year, is not affordable for a country in transition. The “electoral rush” during 1994-1998 presents an interest in terms of politics, but its social-economic consequences are horrible. The current Constitution can be and it is perfect as an efficient remedy against dictatorship, but it is not suitable for Moldovan realities in the transition period.

In other words, the negative experience of monetarist policy applied in the Republic of Moldova in no case derives from some kind of erroneous principles laid on its basis. Certainly, the Moldovan society as a whole was not able to cope with the tasks, imposed by its transition to market economy. All the years after the economic reforms were launched, Moldova did not have any political force to consequently and competently promote the economic reform. Although, during those two years lots of solemn declarations were made in Moldova regarding the fidelity to market economy principles, in reality a real political will was missing, without which nothing can be reached. The Constitution of the Republic of Moldova states solemnly: “The market, free economic initiative, loyal competition are the basic factors of the economy”. The reality has showed, that each of the set forth moments cannot be realized in a society which understood democracy as somebody’s possibility to steal, whereas the others envy it.

11. External impacts: the Russian financial crisis and the Moldovan economy

1. The August 1998 financial crisis in Russia affected many countries in transition to a market economy, even those where economic stabilization, liberalization and structural restructuring has been well advanced, such as the Baltic States, for instance. For several months Moldova resisted the financial turbulence of her neighbor, but then, unable to meet conditions put forward by international financial institutions and bilateral donors and thereby to receive the badly needed assistance, it had to yield to balance of payments current account pressures. The Moldovan lei has been effectively strongly devalued and the country found itself close to an international default. After seven years of structural transformation and attempts of sustained macroeconomic stabilization, Moldova's adjustment to the Russian financial crisis was closer to that of Ukraine rather than that of the Baltics, not to mention the Vyshegrad countries.

2. The causes for the Russian crises are subject to intensive investigation. Its immediate cause was the collapse of confidence of financial investors in Russia preceded by a fail of Russia's government to roll over its matured treasury bills and growing fear of default and devaluation. Among other causes were the structural weakness of Russia's banking sector, a fall in assets prices in stock exchange, decline in Russia's oil-export revenue, as well as the increasing risk-awareness of global financial investors following a rather spectacular collapse of some – until then very dynamic – Asian economies. However, at the roots of the crises there is a series of failed and aborted financial stabilization programs, and Russia's inability to scale back public finance requirements on the one hand, and lack and/or failure of many structural reforms, including privatization, restructuring of the state-owned enterprise sector, slow and corrupt development of the private sector, failed energy-saving programs, lack of reforms in agriculture, and last but far not least, huge money wages rises, higher than in other CIS countries, yet totally unjustified by productivity gains or improved liquidity of the enterprise sector but granted on political grounds.

3. With exports to Russia representing 60 per cent of Moldova's total exports, and imports from Russia representing 40 per cent of total Moldova's imports, the short-term results had to be the inversion of the Moldova's export surplus, especially that Moldova's imports from Russia consist mainly of gas, oil and other raw materials, i.e. their price elasticity is low, and Moldova's exports are mainly food and agricultural products, where price competition is sharp, and in the face of past appreciation of the Moldovan lei, profit margins of exporters are thin (if at all positive). Moreover, the low price elasticity of Moldova's imports from Russia imply additional inflationary push across the board. Ukraine, which is also an important trading partner for Moldova, undergoes possibly even a greater financial crises than that of Russia. Can Moldova cushion those external shocks and what it should do in order to achieve this?

4. First of all it must be noted that with some respects, macroeconomic stabilization in Moldova, after seven years of reforms, appears to be more solid than in Russia and Ukraine. Its public finance requirement is lower than in latter two countries as are the respective yields on treasury bills and the costs of financing the public debt. Also other 'hard' components of government spending represent a smaller proportion of the GDP.

True, budget deficit on commitments basis in Moldova got out of control, with pension and

government sector wage arrears more than doubling the cash-based budget deficit, yet the new government already prior to the crisis was working hard on containing this problem in the 1999 budget.

5. More importantly, next to providing financial stability, a critical package of structural measures have been carefully prepared and agreed upon between the main coalition partners and with the international financial institutions. Once this package is introduced, Moldova may immediately receive a USD 28 million loan from the IMF and a USD 30 million loan from the World Bank. Although the money lent is relatively insignificant from the viewpoint of the donors, it will provide the necessary breathing space for the country and allow for the reform included into the package deliver their effects, even though with regard to some of them their respective maturity periods are rather long.

6. The necessary package of measures on stabilization of the financial situation in the Republic of Moldova was presented by Deputy Prime Minister Ion Sturza in the Parliament already on September 10, 1998. It includes among other things: (i) the introduction of a temporary import surcharge, of 5 percent; (ii) the introduction of reference prices for export and import transactions (for *ad valorem* tax-liability assessment); (iii) elimination of grace-periods for payment of excises on oil products (in order to eliminate tax and tariff avoidance); (iv) rescheduling of credits from commercial banks to the enterprise sector under government guarantees (in order to postpone commercial banks requests for repayments); (v) special measures against enterprises which do not reimburse credits received directly from the budget (such measures as arrest to accounts, confiscation of assets, etc.; 1 billion lei of such credits have been granted between 1992 and 1997); (vi) elimination of technical credits from the budget; (vii) cancellation of 22 million lei loan to agrarian producers; and, following a more elaborated schedule, a reduction by 20 percent of budget expenditures. Altogether 200 million lei is to be thus saved.

7. Financial stabilization will be reinforced by such additional measures as: (i) protection of foreign currency reserves through restrictions of currency transfers (introduction of a USD 5000 monthly limit to be taken away from the country; through request for authorization by the central bank of non-commercial transfers made by economic agents; and through restructuring of the foreign exchange operations and raising their required statutory funds; (ii) maintaining of the banking sector liquidity through obligation that T-Bills are serviced by the Ministry of Finance and handled through open market operations; and through recommendation to the commercial banks to reschedule their credits for economic units which are oriented towards the Russian, Belarus and Ukrainian markets; (iii) maintaining stability on the Treasury Bills market. At the same time, in order to provide some immediate assistance to the people, all current budget revenues are to be spent for payment of wages, pensions and for preparation for the winter period.

8. Of the most important structural changes next to more vigorous advancement of privatization and restructuring of the enterprise sector (most of the already privatized large enterprises including), and a less corrupt development of the private sector, including a genuine liberalization of its operations, the government prepared package includes (i) quick advancement of the pension reform; (ii) introduction of the administration-territorial reform; (iii) adjustments to the Land Code; and (iv) the energy sector restructuring. Of these I personally consider (iv) and (iii) of really critical importance, while both (i) and (ii) are still not well thought out and (i) at any rate will have a very long maturity period.

9. Regarding the Restructuring and Privatization of the Energy Sector, of course, any

tangible reduction of fuel and energy consumption per unit of output will be of paramount importance for a fall in import intensity of GDP and therefore for the improvement in the trade balance of Moldova. This implies among other things the introduction of planned rises in gas, electricity and heating tariffs to their respective costs of delivery without any further delay, but the respective social protection measures including. Important as it is, this is a medium-term measure, however. Acceleration of restructuring of the energy sector, and its demonopolization and privatization must go well beyond the already adopted new laws - on electricity, and on natural gas. Apart from this, a law on energy conservation, and a law that would enable privatization of individual power plants must also be quickly passed. Other measures put forward by the government, such as (i) take-over by the government of the debts of eight energy sector companies to be privatized; (ii) debt-settlement agreements with the energy sector enterprises; (iii) canceling of the netting-out operations with the energy sector; (iv) canceling of barter transactions in settling accounts for energy services; (v) attracting economic agents to enforce collection of payments due to the energy sector; (vi) re-examining the top management in the energy sector; and (vii) establishing the responsibility of the managers of budgetary units for over-consumption of energy resources, also need to be fast implemented.

10. Regarding the agricultural sector, it is worth while to note that nearly 55 per cent of total exports of Moldova is represented by processed food, drinks and tobacco, 8.5 per cent by live animals, animal products and non-processed meat, and 8.6 per cent by fresh vegetables and fruits (the 1997 export structure), i.e. exports of processed and non-processed agricultural products represent together 72 per cent of total exports (over 83 per cent of total exports to the CIS countries). Let alone on these grounds, acceleration of privatization of agricultural farms and food processing enterprises, limiting bureaucratic impediments to their restructuring and modernization by private sector, and facilitating their access to new technologies and markets would improve their export potential and secure improved standards of living in Moldova. Yet, although the aforementioned adjustments to the Land Code were already passed last September by the Parliament, agricultural and agro-processing restructuring has hardly started in Moldova as yet.

11. In conclusion it may be argued that after seven years of reforms Moldova succeeded in achieving some measure of macroeconomic stability and an impressive reduction in rates of inflation. Yet, unsupported by medium term measures that would make fiscal discipline sustainable nor by satisfactory advancement of structural changes, the Moldovan economy fell back on a development trajectory that may soon undermine past achievements. In terms of macroeconomic stabilization and restoration of short-term equilibrium of the current account of the balance of payments, a rather insignificant assistance of the IMF and the World Bank will be satisfactory, provided, however, that medium term measures that would secure fiscal equilibrium and structural reforms are also implemented. In fact, IMF and the World Bank assistance is conditional upon their implementation. However, even if their assistance were not conditional upon these reforms, they would still be a must in order successfully to complete Moldova's transformation to a market economy.

12. Our neighbors: recent developments in the Romanian economy

While the year of 1997 represented the first serious attempt to adopt radical reforms by the new democratic government elected in October 1996, in 1998 the speed of transformations was slowed down. No significant changes can be emphasized, compared to what was expected. The output growth is still negative, despite its dramatic fall of 6.6% in 1997, the deficit of the budget is high, and the rhythm of privatization is very slow. No major structural reforms can be mentioned in the Romanian society; as a consequence, the country rating provided by international specialized institutions places Romania on an unfavorable position.

The political framework

The main element which have determined such a situation is the political crisis generated in December 1997 by the Democratic Party (PD) of the former Prime Minister Petre Roman. The PD belongs to the current coalition CDR (Democratic Convention from Romania). In December 1997, after the government reshuffling, this party announced its intention to quit the coalition if the Prime Minister Victor Ciorbea is not replaced. PD was not satisfied by the way of conducting the reforms, accusing the Prime Minister in political conservatism and inability to undertake radical measures in the economy. As a result, the first two months of 1998 were practically inactive. The coalition accepted Roman's conditions, and Radu Vasile was nominated as a new Prime Minister.

The new government announced its intention to speed up the reforms, but in reality the progress has not been significant. The high influence of politics on all economic decisions has impeded such a progress. A controversial military contract with Bell Helicopters has determined tensions within the cabinet, the Prime Minister deciding in September 1998 to replace the Ministry of Finance Daniel Daianu, an internationally recognized specialist who refused to sign the contract.

The fragility of the leading coalition is still a major deficiency for the political and economic environment. In September 1998, another political group – the UDMR (Democratic Union of Hungarians from Romania) – announced its intention to quit the coalition because the Parliament refused to vote the creation of a public university exclusively for the Hungarian minority from Transilvania. Fortunately, UDMR cancelled its initial decision in October, when the CDR accepted a compromise – a multi-lingual university. In the middle of November, UDMR made a new tentative to obtain a Hungarian university, which re-opened the conflict.

Beside these political conflicts within the coalition, the confidence of population in the government has suffered because of several situations when high officials were denounced for corruption, some of them close to President Constantinescu. The confusion is amplified by the fact that the coalition has hesitated to take decisive measures with respect to the bad performance of SOF (State Ownership Fund) with respect to the speed of privatization. The responsibility belongs almost exclusively to the SOF president Sorin Dimitriu, whose replacement has been systematically avoided. Only at the end of October 1998 Sorin Dimitriu was dismissed. The SOF restructuring, announced by the new president, seems to be postponed for an indefinite future.

The economic evolution in 1998

The economy has recorded a serious decline during the first eight months of 1998. The industrial production represented only 81.5 % from its level of the corresponding period of

1997, the most dramatic fall being recorded in manufacturing, where the production of durable goods represents only 54.6% of the 1997 level (eight months). The government prognosis for the whole year of 1998 shows a decrease of industrial production by 6%, as compared to 1997, but the up to know evolution will determine, according to certain opinions, an effective fall of at least 11%.

In agriculture, the official estimates show a 2% decline of total production in 1998, compared to 1997. However, this number seems to be underestimated, since during the first 8 months of this year both vegetable production and livestock being much below the corresponding level of 1997 period.

Public investment has recorded also a significant decrease (15.8% for the first semester), while in the private sector the investment has increased by 6.4% during the same period. The weight of bank credits in overall investment resources is still very low: 6.6% for the whole economy, and only 4.5% in the private sector.

The exports of the first seven months decreased by 2.1%, as compared to the same period of 1997, while the imports increased by 3.1% during the same period. As a consequence, the commercial deficit FOB/CIF increased by 22.24% during the first seven months of this year, compared to the same time horizon of 1997. Even in the private sector the foreign trade situation in 1998 is worse than the previous year: exports have decreased by 7.6%, while imports increased by 1.9%.

The exchange rate shows a slight depreciation of the ROL in nominal terms (13.9% at the end of September, compared with December 1997), but a real appreciation of about 18%. The rhythm of depreciation accelerated at the beginning of November, when the ROL approached the 10000 lei/\$ level, but NBR considers that this tendency is still within the limits set in the beginning of the year.

The value of services for population decreased by 16.5% in the first seven months of 1998, compared with the same period from 1997, the most significant fall being recorded in tourism (30.9%).

The average monthly rate of inflation for the period January-August 1998 has been 3.0%, while the monthly rate for the same period of 1997 was 9.7%, in average. This is equivalent with an overall inflation rate of 26.5% at the end of August 1998 compared to December 1997. From this point of view, 1998 is the most successful year of transition in Romania, when the effective inflation rate seems to be below the proposed target of 45%. The lowest increase of prices in 1998 corresponds to food products (1.9% average monthly rate), while the services recorded the highest increase – 4.6% per month, in average. The lowest rate of inflation in 1998 was recorded in September (0.6%), which is also the lowest monthly rate from the first price liberalization in October 1990.

The average gross monthly salary in August 1998 was 1402317 lei (about US \$ 160), while the net monthly salary, as the average for the economy, increased up to 1122880 lei (US \$ 120). In average, the ratio between the index of net nominal average salary and CPI was 101.6 as against previous month, 113.8 as compared to August 1997, and 62.2% from the same ratio corresponding to October 1990.

At the end of August 1998 the number of registered unemployed was 848300, by 22700 less than previous month and by 139800 more than the same month of 1997. The decreasing tendency of unemployment starts in February 1998, but this is mainly due to the expiration of the payment period of unemployment benefits for a large proportion of those who have previously lost their job. The unemployment rate in August was 8.5 % (8.8 % for feminine labor force). In August 1997, the rate of unemployment was 7.1% (7.7% for women). The highest level of unemployment remains in counties like Vaslui, Neamt, Valcea, and Suceava (more than 12%).

The gross domestic product corresponding to the first quarter of 1998 (62120.5 billion lei in current prices) represented only 90.6 % of its level of the same period from 1997. The

estimations for the first semester of this year show a decline by 5.2% compared to the first semester of 1997. Even though the government announced initially a target of 0 % real growth of GDP for the whole year of 1998, the up to now evolution of the main sectors of the economy indicate an overall decline of at least 4.5% until the end of the year.

The evolution of reforms

We already argued that the political instability has discouraged the economic reforms. The proposed tasks have been fulfilled only partially and with significant delays. The privatization of ROMTELECOM, considered to be the most important event of 1998, has been postponed several times because of low interest shown by foreign investors. In November, OTC bought 35% of shares for US \$ 650 million.

The privatization of three commercial banks (BRD – Romanian Bank for Reconstruction and Development, Bancpost and Banca Agricola) will not be possible until the end of this year, even though BRD has been prepared for privatization since 1993 and Banca Agricola was re-capitalized by a huge infusion of capital.

The transformation of Regies Autonomes in commercial companies to be privatized has been only partially done. The most important step with this respect is the restructuring of two natural monopolies: the electricity company RENEL, respectively SNCFR – the railway transportation company. However, the restructuring means only the reorganization of the two state owned National Companies by dividing them into functional units. Their effective restructuring will require at least two years from now on.

The institutional reforms have been also delayed. The law on the status of public servants has not been passed by the Parliament. The project was submitted to the legislative body almost two years back. The government reorganization, initially planned for the middle of 1998, is still on the government agenda.

The decision to close down large loss making state enterprises has not been taken. Only 16 companies were declared bankrupt and closed down in 1997, but the Romanian economy is currently facing the burden of about 150 firms that have accumulated huge arrears and losses, some of them (around 80 commercial companies) producing negative value added. Half of industrial producers have accumulated large debts to RENEL and ROMGAZ, the total value of arrears to RENEL being almost 7000 billion lei (around US \$ 800 million) at the end of the third quarter of 1998.

In the field of fiscal policies, the introduction of the tax on global income, announced for the beginning of 1998, has been postponed indefinitely. The tax collection does not show any improvement, at present only 53% of contributions due to the budget being effectively paid by economic agents. The 1999 project of the state budget is not yet done, mainly due to serious conflicts between the government and the parliament with respect to certain fiscal facilities voted by the legislative body, a measure that contradicts flagrantly the government recommendations.

Among the positive results of 1998, it should be mentioned the reform of educational system, and the preparation of the legal framework for introducing the system of private pensions. In the first case, a more flexible system was adopted, according to Western European rules. The reform of the pension system implies the introduction, starting with 1999, of the private funds that will gradually replace the current Pay-as-you-go system. The pension reform is probably the most important step undertaken by Romania during the period of transition.

Annex: Main economic indicators in 1998

Month	Ind. Prod.				% previous month				
		Employment			Net average salary				
		Total	Ind.	Agr.	Total	Ind.	Agr.	Energy	Banks
January	100.5	98.8	98.5	102.6	96.3	96.8	96.6	108.5	94.6
February	103.4	99.3	99.4	99.2	99.3	100.3	99.5	99.2	91.5
March	99.4	99.4	99.4	104.4	108.6	108.6	105.3	103.1	101.9
April	91.3	100.7	99.7	106.9	109.6	110.5	113.3	124.8	150.9
May	100.6	100.1	99.4	104.3	95.8	94.2	100.9	85.5	76.8
June	99.1	99.8	99.1	101.6	104.1	104.7	103.2	105	99.8
July	93.8	99.3	98.9	101.8	105.6	108.2	108	120.3	111.1
August	93.4	99.1	98.9	96.9	102.2	99.9	101.5	88.2	101.3

Month	Exchange rate Lei/US\$ (average)	CPI (Previous month = 100)	Unemploy- ment rate (%)	Exports Million \$	Imports Million \$
January	8293.4	104.9	9.2	585.5	674.9
February	8230.9	107.2	9.6	655.1	722.5
March	8207.1	103.8	9.5	678.5	1008.5
April	8379.6	102.7	9.3	648.3	887.2
May	8477.3	102.3	9.0	670.4	967.4
June	8569.4	101.3	8.8	716.8	849.2
July	8699.4	101.3	8.7	719.5	863.4
August	8781.2	100.6	8.5	NA	NA
September		102.7			

Annex. Republic of Moldova and other 24 countries in transition, main social and economic indicators

Population

Indicators	Population	Land area	Urban population	Labor Force	Population	Life expectancy at birth	
	<i>millions</i>	<i>Th. sq. km</i>	<i>% of total</i>	<i>Avg. Growth (%)</i>		<i>Years</i>	<i>Years</i>
	1997	1997	1997	1990-97	1990-97	Males 1996	Females 1997
Albania	3	27	38	0.8	0.2	69	75
Armenia	4	28	69	0.8	0.9	69	76
Azerbaijan	8	87	56	1.4	0.9	65	74
Belarus	10	207	72	-0.1	0	63	74
Bulgaria	8	111	69	-0.9	-0.7	67	75
Croatia	4	56	57	0	...	68	77
Czech Republic	10	77	66	0.4	-0.1	70	77
Estonia	1	42	74	2.4	2.3	63	76
Georgia	5	70	59	-0.1	-0.1	69	77
Hungary	10	92	66	0	-0.3	65	75
Kazakhstan	16	2,671	60	-0.1	-0.4	60	70
Kyrgyz Republic	5	192	39	1.3	0.7	62	71
Latvia	2	62	73	-1.1	-1.1	63	76
Lithuania	4	65	73	-0.2	-0.1	65	76
Macedonia, FYR	2	25	61	1.2	0.7	70	74
Moldova	4	33	53	0.1	-0.1	64	71
Poland	39	304	64	2.7	2.3	68	77
Romania	23	230	57	0.4	0.1	65	73
Russian Federation	147	16,889	77	0.1	-0.1	60	73
Slovak Republic	5	48	60	0.7	0.2	69	77
Slovenia	2	20	52	0.1	-0.1	71	78
Tajikistan	6	141	32	2.2	1.8	66	72
Turkmenistan	5	470	45	3.5	3.4	62	69
Ukraine	50	579	71	-0.4	-0.4	62	73
Uzbekistan	24	414	42	2.7	2	66	72

Quality of life and Social Indicators

Indicators	Infant Mortality rate	Fertility rate	Under-5 mortality rate	Public expenditure % GNP		International Poverty Lines		Index Food Production
	<i>Per 1000 live births</i>	<i>Birth per woman</i>	<i>Per 1000</i>	<i>Education</i>	<i>Health</i>	<i>Pop. below \$1/day</i>		<i>1989-91 = 100</i>
	1996	1996	1996	1995	1990-95	year	%	1994-96
Albania	37	2.6	40	3.4	2.7		...	...
Armenia	16	1.6	20	....	3.1		...	78
Azerbaijan	20	2.1	23	3.0	1.4		...	55
Belarus	13	1.3	17	5.6	5.3	1993	<2	68
Bulgaria	16	1.2	20	4.2	4.0	1992	2.6	68
Croatia	9	1.6	10	5.3	8.5		...	57
Czech Republic	6	1.2	10	6.1	7.7	1993	3.1	82
Estonia	10	1.3	16	6.6	6.3	1993	6.0	...
Georgia	17	1.5	19	5.2	0.8		...	71
Hungary	11	1.5	13	6.0	6.8	1993	<2	73
Kazakhstan	25	2.1	30	4.5	2.2	1993	<2	70
Kyrgyz Republic	26	3.0	36	6.8	3.7	1993	18.9	81
Latvia	16	1.2	18	6.3	4.4		...	57
Lithuania	10	...	13	6.1	5.1	1993	<2	65
Macedonia, FYR	16	1.4	18	5.5	7.3		...	96
Moldova	20	2.9	24	6.1	4.9	1992	6.8	63
Poland	12	1.6	15	4.6	4.8	1993	6.8	83
Romania	22	1.3	28	3.2	3.6	1992	17.7	97
Russian Federation	17	1.3	25	4.1	4.1	1993	<2	71
Slovak Republic	11	1.5	13	4.4	6.0	1992	12.8	76
Slovenia	5	1.3	6	5.8	7.4		...	96
Tajikistan	32	3.7	38	8.6	6.4		...	70
Turkmenistan	41	3.3	50	...	2.8	1993	4.9	121
Ukraine	14	1.3	17	7.7	5.0		...	70
Uzbekistan	24	3.4	35	9.5	3.5		...	108

Economic Growth

Indicators	GDP per capita		GNP PPP		Gross domestic product		GDP implicit deflator
	\$	rank	per capita \$	rank	Millions \$	Avg. growth % annual	Avg. growth % annual
	1997	1997	1997	1997	1997	1990-97	1990-97
Albania	750	84	...	...	2,276	1.8	58.1
Armenia	530	95	2,280	79	1,401	-21.2	860.5
Azerbaijan	510	96	1,520	96	4,399	-15.1	447.8
Belarus	2,150	58	4,840	52	22,462	-6.5	564.8
Bulgaria	1,140	74	3,860	61	9,484	-3.5	79.8
Croatia	4,610	36	...	...	19,081	...	218.1
Czech Republic	5,200	31	11,380	28	54,890	-1.0	17.7
Estonia	3,330	47	5,010	50	4,617	-4.3	92.1
Georgia	840	82	1,980	85	3,028	-26.2	2,279.5
Hungary	4,430	37	7,000	39	44,845	-0.4	22.5
Kazakhstan	1,340	69	3,290	69	21,039	-10.5	604.9
Kyrgyz Republic	440	99	2,040	83	1,754	-12.3	256.2
Latvia	2,430	54	3,650	64	5,024	-10.7	112.0
Lithuania	2,230	56	4,510	56	9,265	-4.5	139.9
Macedonia, FYR	1,090	76	...	...	2,061	...	149.4
Moldova	540	94	1,440^a	104^a	1,803	-8.14^b	307.7
Poland	3,590	43	6,380	46	135,659	3.3	8.7
Romania	1,420	68	4,290	58	35,204	0.0	124.5
Russian Federation	2,740	51	4,190	59	440,562	-9.0	394.0
Slovak Republic	3,700	41	7,850	36	19,565	0.4	12.7
Slovenia	9,680	27	12,520	26	17,905	...	32.1
Tajikistan	330	110	930	110	1,990	-16.4	394.3
Turkmenistan	630	91	1,410	97	4,399	-9.6	1,074.2
Ukraine	1,040	77	2,170	82	44,007	-13.6	800.5
Uzbekistan	1,010	78	2,450	76	23,857	-3.5	546.5

a. Data for 1996; b. Data for 1993-97

Energy Use and Structure of Output

Indicators	Electric power		Commercial energy use		Value added as % GDP			
	<i>Consumption Per Capita</i>	<i>Transmission, distribution losses</i>	<i>Th. Ton oil equivalent</i>	<i>Kg.oil equiv/ capita</i>	Agriculture	Industry	Manufacturing	Services
	<i>Kilowatt- hours, 1995</i>	<i>%output, 1995</i>	<i>1995</i>	<i>1995</i>	<i>1997</i>	<i>1997</i>	<i>1997</i>	<i>1997</i>
Albania	623	51	1,020	314	55	21	...	23
Armenia	811	39	1,671	444	44	35	25	20
Azerbaijan	1,806	23	13,033	1,735	22	18	18	60
Belarus	2,451	15	23,808	2,305	16	41	35	43
Bulgaria	3,415	13	22,878	2,724	10	33	...	57
Croatia	2,074	19	6,852	1,435	12	25	20	62
Czech Republic	4,654	8	39,013	3,776	...	...	...	...
Estonia	3,022	20	5,126	3,454	7	28	16	65
Georgia	1,057	25	1,850	342	35	35	20	29
Hungary	2,682	14	25,103	2,454	7	32	24	61
Kazakhstan	3,106	15	55,432	3,337	13	30	6	57
Kyrgyz Republic	166	28	2,315	513	52	19	8	29
Latvia	1,789	32	3,702	1,471	9	33	22	58
Lithuania	1,711	15	8,510	2,291	13	32	20	55
Macedonia, FYR	2,443	12	2,572	1,308	11	25	...	64
Moldova	1,517	18	4,177	963	50	23	8	27
Poland	2,324	13	94,472	2,448	6	39	...	55
Romania	1,603	11	44,751	1,941	21	40	...	39
Russian Federation	4,172	10	604,461	4,079	7	39	...	54
Slovak Republic	4,075	8	17,447	3,272	5	31	...	64
Slovenia	4,710	5	5,583	2,806	5	38	28	57
Tajikistan	2,367	12	3,283	563	...	...	...	...
Turkmenistan	1,109	10	13,727	3,047	...	...	...	...
Ukraine	2,785	10	161,586	3,136	13	39	...	48
Uzbekistan	1,731	10	46,543	2,043	26	27	8	47

Structure of Demand

Indicators	Structure of Demand, % GDP						Military Expenditures
	<i>Private consumption</i>	<i>G. Government consumption</i>	<i>G. domestic investment</i>	<i>G. domestic savings</i>	<i>Exports goods services</i>	<i>Resource balance</i>	<i>% of GDP</i>
	1997	1995	1997	1997	1997	1997	1995
Albania	94	13	21	-7	13	-27	1.1
Armenia	115	13	10	-28	24	-38	0.9
Azerbaijan	83	8	28	10	19	-19	2.8
Belarus	59	23	25	17	44	-7	0.8
Bulgaria	71	12	14	17	65	3	2.8
Croatia	66	30	15	3	42	-11	10.5
Czech Republic	51	22	35	27	55	-8	2.3
Estonia	61	25	27	14	73	-13	1.1
Georgia	100	7	4	-7	17	-11	2.4
Hungary	64	10	27	26	39	-1	1.5
Kazakhstan	68	12	23	20	31	-3	0.9
Kyrgyz Republic	87	17	19	-4	31	-23	0.7
Latvia	70	20	19	10	46	-9	0.9
Lithuania	70	18	21	11	52	-10	0.5
Macedonia, FYR	72	18	17	10	41	-7	3.3
Moldova	66	20	28	14	52	-14	2.1
Poland	64	18	22	18	26	-4	2.3
Romania	70	11	25	19	27	-7	2.5
Russian Federation	63	11	22	25	23	3	11.4
Slovak Republic	49	24	38	27	57	-11	3.0
Slovenia	57	20	23	22	55	-1	1.5
Tajikistan	71	11	17	18	114	1	3.7
Turkmenistan	...	...	...	...	...	...	1.7
Ukraine	58	22	23	20	46	-2	2.9
Uzbekistan	66	25	16	9	31	-7	3.8

Foreign Sector

Indicators	Trade share GDP	Hi Tech exports	Net Energy Imports	G. international reserves	Current Account Balance	External Debt	Foreign Dir Invest	Offic Devel Assistance
	%	% of mfg. Exports	%commercial energy use	Millions \$	Millions \$	% GNP	millions \$	% GNP
	1996	1996	1995	1997	1996	1996	1996	1996
Albania	52	...	8	342	-107	32	90	8.1
Armenia	86	...	85	239	-219	27	18	18.2
Azerbaijan	62	...	-13	466	-666	10	601	3.0
Belarus	96	...	88	394	-909	4	18	0.4
Bulgaria	127	...	57	2,549	-56	89	115	1.9
Croatia	95	17	43	2,690	-1,452	24	349	0.7
Czech Republic	117	14	22	10,032	-4,299	42	1,435	0.2
Estonia	159	19	39	760	-423	9	150	1.4
Georgia	44	...	74	...	-216	26	40	7.1
Hungary	79	19	47	8,509	-1,678	62	1,982	0.4
Kazakhstan	65	...	-16	2,225	-752	14	310	0.6
Kyrgyz Republic	86	24	41	170	-404	37	46	13.9
Latvia	102	16	91	776	-280	9	328	1.6
Lithuania	115	23	61	1,064	-723	16	152	1.2
Macedonia, FYR	86	...	37	280	-288	74	8	5.3
Moldova	118	9	99	366	-214	39	41	2.1
Poland	49	11	0	20,662	-3,264	31	4,498	0.6
Romania	60	7	32	4,676	-2,571	23	263	0.6
Russian Federation	42	...	-54	17,727	11,399	25	2,479	0.0
Slovak Republic	126	16	72	3,604	2,090	41	281	0.7
Slovenia	111	16	54	3,310	39	21	186	0.4
Tajikistan	228	...	60	...	-84	24	16	5.6
Turkmenistan	...	...	-137	...	43	18	108	0.5
Ukraine	93	...	50	2,358	-1,186	18	250	0.9
Uzbekistan	69	...	-6	...	-1,075	9	55	0.4

Investment

Indicators	Private investment	Dom. Credit by Banking Sector	C. Government Finances	Money and Quasi-money	Interest rate %		
	% G. Dom. Fix Investment	% GDP	Deficit/surplus, % GDP	% annual growth M2	Deposits	Credits	real
	1996	1997	1996	1996	1996	1996	1996
Albania	...	44.8	-9.0	43.8	16.8	24.0	8.2
Armenia	33.6	9.1	...	32.8	32.2	66.4	-18.9
Azerbaijan	...	11.1	...	17.1	...	162.5	-63.0
Belarus	...	17.7	...	52.4	32.3	64.3	12.3
Bulgaria	85.0	119.1	-16.0	117.8	74.7	123.5	4.7
Croatia	59.6	46.4	-0.5	49.4	5.6	22.5	16.6
Czech Republic	...	78.5	0.0	6.4	6.8	12.5	-1.5
Estonia	80.2	30.1	-0.2	36.4	6.1	13.7	-6.8
Georgia	73.7	...	...	...	...	...	...
Hungary	...	49.2	...	18.4	26.1	32.6	4.6
Kazakhstan	98.8	7.9	...	...	6.0	9.5	4.2
Kyrgyz Republic	87.5	26.2	...	...	30.7	58.6	20.3
Latvia	89.3	13.0	-1.6	18.6	11.7	25.8	9.7
Lithuania	86.3	12.1	-3.7	-3.0	8.4	21.6	-3.6
Macedonia, FYR	...	35.2	...	...	...	...	...
Moldova	78.5	21.9	-10.0	14.8	25.4	36.7	13.1
Poland	81.9	35.3	-2.2	29.3	20.0	26.1	6.5
Romania	73.8	9.6	-4.0	64.1	...	...	...
Russian Federation	91.1	0.0	-4.4	33.0	55.1	146.8	69.6
Slovak Republic	...	60.0	...	16.2	15.0	23.7	12.8
Slovenia	26.7	36.0	...	21.3	14.9	19.5	10.3
Tajikistan	...	...	...	...	13.6	37.2	11.9
Turkmenistan	...	1.7	...	449.1	...	...	...
Ukraine	...	14.9	...	35.4	33.6	79.9	9.6
Uzbekistan	...	...	...	...	...	...	...

Communications and Information

Indicators	Internet Hosts	TV sets	Telephone Main Lines	PCs	Mobile phones	Road Traffic	Paved Roads
	10000 people	per 1000 people				M. vehicles km	% total
	Jul-97	1996	1996	1996	1996	1996	1996
Albania	0.32	173	19	...	1	...	30
Armenia	0.88	216	154	...	2	...	30
Azerbaijan	0.11	212	85	...	1	2,207	...
Belarus	0.44	292	208	...	1	5,493	70
Bulgaria	6.65	361	313	295.2	3	19	92
Croatia	14.80	251	309	20.9	14	...	82
Czech Republic	47.66	406	273	53.2	19	37,350	100
Estonia	45.35	449	299	6.7	47	...	53
Georgia	0.55	474	105	...	0	165	94
Hungary	33.29	444	261	44.1	46	...	43
Kazakhstan	0.70	275	118	...	0	8,617	81
Kyrgyz Republic	0.23	238	75	...	...	2,562	91
Latvia	21.30	598	298	7.9	11	...	13
Lithuania	7.46	376	268	6.5	14	198	82
Macedonia, FYR	2.15	170	170	...	0	4,247	64
Moldova	0.39	307	140	2.6	0	910	87
Poland	11.22	418	169	36.2	6	118,530	65
Romania	2.66	226	140	5.3	1	33,531	51
Russian Federation	5.51	386	175	23.7	2	...	79
Slovak Republic	20.47	384	232	186.1	5	651	98
Slovenia	85.66	375	333	47.8	20	8,037	82
Tajikistan	0.00	279	42	...	...	...	83
Turkmenistan	0.00	163	74	...	...	...	81
Ukraine	2.09	341	181	5.6	1	60,168	95
Uzbekistan	0.06	190	76	...	0	...	87

SOURCES: WORLD DEVELOPMENT REPORT, KNOWLEDGE FOR DEVELOPMENT, THE WORLD BANK, 1998-99
WORLD DEVELOPMENT INDICATORS, THE WORLD BANK, 1998
INTERNATIONAL FINANCIAL STATISTICS, INTERNATIONAL MONETARY FUND, MARCH 1998
ECONOMIC TRENDS, QUARTERLY ISSUE, MOLDOVA, JANUARY-MARCH 1998, EUROPEAN COMMISSION, DGIA, NIS/TACIS SERVICES

World growth, 1981-2007

(Annual percentage change in real GDP)

Region	Forecasts							
	1981-90	1991-97	1997	1998	1999	2000	2001-07	Previous year's forecast
World total	3.1	2.3	3.2	1.8	1.9	2.7	3.2	3.4
High-income countries	3.1	2.1	2.8	1.7	1.6	2.3	2.6	2.8
OECD countries	3	2	2.7	1.9	1.6	2.2	2.5	2.7
Non-OECD countries	6.6	6.4	5.3	-1.8	2	3.9	5.2	5.7
Developing countries	3	3.1	4.8	2	2.7	4.3	5.2	5.5
East Asia	7.7	9.9	7.1	1.3	4.8	5.9	6.6	7.5
Europe and Central Asia	2.6	-4.4	2.6	0.5	0.1	3.4	5	5.2
Latin America and the Caribbean	1.9	3.4	5.1	2.5	0.6	3.3	4.4	4.4
Middle East and North Africa	1	2.9	3.1	2	2.8	3.1	3.7	3.7
South Asia	5.7	5.7	5	4.6	4.9	5.6	5.5	5.9
Sub-Saharan Africa	1.9	2.2	3.5	2.4	3.2	3.8	4.1	4.2
<i>Memorandum items</i>								
East Asian crisis countries ^a	6.9	7.2	4.5	-8	0.1	3.2	5.2	6.8
Transition countries of Europe and Central Asia	2.4	-5.5	1.7	-0.4	-0.6	3	4.8	5.3
Developing countries, excluding the transition countries	3.3	5.3	5.3	2.5	3.2	4.5	5.2	5.6
Developing countries, excluding transition and ASEAN-4 ^b	3.1	5.1	5.5	3.9	3.6	4.7	5.2	5.4

Note: GDP is measured at market prices and expressed in 1987 prices and exchange rates. Growth rates over historic intervals are computed using least squares method.

a. Indonesia, the Republic of Korea, Malaysia, Philippines, and Thailand.

b. Asian crisis countries, excluding the Republic of Korea.

Source: World Bank data and baseline projections November 1998.